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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1954

No. 364 01

THE UNITED STATES, PETITIONER,

vs.

ANDERSON, CLAYTON & CO.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

PETITION FOR CERTIORARI FILED DECEMBER 31, 1954

CERTIORARI GRANTED FEBRUARY 7, 1955

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1954

No. 504

THE UNITED STATES, PETITIONER,

vs.

ANDERSON, CLAYTON & CO.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS.

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1 In The United States Court of Claims

No. 626-52

ANDERSON, CLAYTON & CO., PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

PETITION—Filed December 30, 1952

To the Honorable Chief Justice and the Associate Justices of the Court of Claims of the United States:

1. The Plaintiff, Anderson, Clayton & Co., is a corporation organized on December 31, 1929, and existing under the statutes of the State of Delaware, with its principal business office at Houston, Texas.

2. Upon the organization of Anderson, Clayton & Co. in 1929 the corporation issued $25,842,375 of its 6½ per cent preferred and 53,312½ shares of its common stock, the capital value of which was fixed at $1 per share, in exchange for 34,875 shares of the Texas joint stock association, also known as Anderson, Clayton & Co., and thereafter dissolved. On or about April 21, 1930 an additional 47,687½ shares of common were sold at $1 a share to the
2 managing officials of the corporation resulting in the following total common stock ownership by the chief managing officials:

W. L. Clayton	44,800
M. D. Anderson	31,000
Lamar Fleming, Jr.	12,000
Harmon Whittington	5,000
D. B. Cannafax	2,750
L. L. Fleming	2,500
6 Minor Officials	1,950
	100,000

3. The capitalization of the corporation, i.e. $25,842,375 of first preferred stock and $100,000 in common stock, was expressly designed to have existing values represented by preferred stocks and to utilize the 100,000 shares of $1 common to adjust the participation of the managing officials in future earnings above the contracted return on first preferred.

4. The ownership of the common stock was surrounded with restrictions which were designed to insure its holding and use as a

method of rewarding management. From the beginning it was understood by the common stockholders, all of whom were active in the business, that the stock was not salable outside the managing directors of the business, and that even within that group the disposition was to be made in accordance with the responsibilities of and contributions to management by the different executives as determined by the holders of at least 75 per cent of the common stock. It was understood that no stockholder was entitled to sell his stock and none could keep it unless the others wanted him to. It was likewise understood from the beginning that the respective
3 interests in the common stock would be adjusted among the managerial group as responsibility changed.

5. On February 14, 1931, an agreement in writing was entered into between corporation and the holders of all its common stock, all of whom were actively engaged in the business. This instrument embodied, among other things, the provisions of the general understanding theretofore existing among the common stockholders with reference to the restrictions upon the holding of the stock and the plan for its use as a method of rewarding management. The agreement provided, in substance, that:

(1) All the common stockholders of corporation agreed to endorse their common stock to Monroe D. Anderson as trustee for a period of 10 years.

(2) The stockholders retained the right to vote their stock.

(3) The stockholders agreed that they could not assign, transfer, or otherwise dispose of their common stock without the written consent of the holders of 75 per cent of the stock.

(4) On the death of any party to the agreement, corporation agreed to purchase the common stock of the deceased party at the value determined as of July 31, immediately preceding the death, according to the provisions made in the contract for the annual determination of value by the executive committee of corporation, but in no event less than $1 per share, plus 6 per cent interest from such date to the date of death.

(5) A consolidated balance sheet for corporation and all its subsidiaries was to be prepared as of July 31 of each year (the
4 end of its fiscal year); and, in addition, for the private use of the individual parties to the agreement, a supplementary balance sheet, adjusted on account of appreciation and depreciation of the value of properties held by corporation and its subsidiaries so as to reflect the the true net worth of corporation (without any allowance for good will), was also to be prepared and approved by the executive committee of corporation as soon after the end of each fiscal year as practicable. The value of the common stock as shown in the supplementary balance sheet was to be fixed as the value of that stock for purposes of the contract.

(6) The owners of 75 per cent of the common stock could at any time in writing request any party to the agreement to sell all or any part of his common stock to corporation, or to such person as they might designate, upon terms agreeable to seller and buyer; and if seller and buyer could not agree, then according to the value fixed for the common stock in the annual supplementary balance sheet approved by the executive committee, as in the case of the death of any party to the contract.

(7) Any owner of common stock held by the trustee under the agreement could elect at any time to withdraw and sell his common stock to corporation upon terms mutually agreeable by giving written notice of his desire to the trustee. If corporation and the party could not agree upon the selling price, then the value fixed in the annual supplementary balance sheet was to be used, substantially in the same way as in the case of death of a party.

5 (8) No dividends could be paid on common stock so long as corporation was indebted in any sum whatever, nor in any event if the dividend would have the effect of lowering the book value of the stock below five million dollars as reflected in the consolidated balance sheet of corporation, nor unless an amount of preferred stock equal to the dividend was retired at the same time.

(9) Any common stock purchased by corporation under the terms of the agreement could be sold to the remaining parties to the agreement or to any other person whom the owners of 75 per cent of the remaining stock might designate in writing.

(10) Any future holder of common stock could become a party to the agreement merely by signing it or giving his consent to its provisions in writing.

(11) All the parties to the agreement agreed that any common stock thereafter acquired by any of them, in whatever manner, should automatically be subject to all the terms of the agreement and should be endorsed to the trustee.

(12) The agreement could be amended, altered, revised, or canceled at any time by an instrument in writing signed by the owners of 75 per cent or more of the common stock.

6. Until the year ending July 31, 1937 the contract value of the common stock was, by authorization and declaration of dividends thereon in second preferred stock, maintained at approximately $1 a share, such course having been abandoned when the

6 Commissioner sought to tax such stock dividends.

7. From time to time also as junior officials assumed more responsibilities and duties, shares of common stock were in pursuance of said agreement and in the ordinary course of business transferred by W. L. Clayton and M. D. Anderson to junior management officials so that upon his death M. D. Anderson held only 18,574 shares of the 31,000 originally issued to him.

8. All of the transfers of the corporation's common stock were made only to persons who occupied positions of managerial responsibility in the business and at the value determined under the agreement.

9. During its fiscal year ending July 31, 1944, Anderson, Clayton & Co. allocated and sold 6,500 shares of its common stock to the managing officials shown at the contracted valuation of $112.68 a share in recognition of increased responsibility and duties:

Names	Shares	Price
H. Whittington	2,000	$225,360.00
Sydnor Oden	1,250	140,850.00
W. H. Koar	1,500	169,020.00
J. M. Johnson	1,250	140,850.00
W. E. Parry	500	56,340.00
Total	6,500	$732,420.00

10. Of the officials to whom the corporation transferred 6,500 shares of the 18,574 purchased from the Estate of M. D. Anderson, Harmon Whittington was the vice-president in charge of trading policies and cotton merchandising activities; W. H. Koar, a vice-president in charge of the New York office and of relations with New York banks; Sydnor Oden, a vice-president in charge of cotton export sales; J. M. Johnson, a vice-president in charge of new plant and industrial activities; and W. E. Parry, the controller and chief accounting officer of the business.

11. The 6,500 shares of stock so allocated and sold was a part of the 18,574 shares acquired by the corporation on December 15, 1939, from the Estate of M. D. Anderson at its contracted valuation of $50.79 per share.

12. The difference between the amount of $330,136 paid the Estate of M. D. Anderson for 6,500 shares at $50.79 a share, its value at the time of the death of M. D. Anderson, in 1939, and $732,420, the price at which such stock was transferred to the managing employees mentioned in 1944 at $122.68 a share was credited by plaintiff to capital surplus and no income was reported for income tax purposes.

13. Following examination, the Commissioner of Internal Revenue determined that Anderson, Clayton & Co. realized a long-term capital gain in the amount of $402,285.00 on which the tax was $100,571.25 and with other adjustments determined a deficiency of $89,337.66, which was paid on August 27, 1947.

14. Claim for Refund in the amount of $100,571.25 was filed by plaintiff on or about October 18, 1947.

15. On or about January 20, 1951, plaintiff received by registered

mail an official notice, dated January 18, 1951, of disallowance of its claim of October 18, 1947.

16. All of the transactions of plaintiff in its common stock were related to its management, and to the proper compensation of managing officers from earnings, transfers were at contractual
8 rather than market values, and no transaction amounted to dealing in its own shares as it might those of another corporation.

17. The defendant wrongfully and illegally refuses to refund, repay, or credit to plaintiff (as provided in Sections 322, 729 and 3770 of the Internal Revenue Code) the amount of $100,571.25 or any part thereof and has rejected plaintiff's claim therefor, and it is of such wrongful and illegal action that plaintiff herein complains.

18. Plaintiff has at all times borne true allegiance to the Government of the United States and has not in any way voluntarily aided, abetted or given encouragement to rebellion against said Government.

19. Plaintiff is the sole and absolute owner of the claim here presented; no transfer or assignment of said claim or any part thereof has been made; and plaintiff is justly entitled to the amounts claimed herein from the United States after allowing all just credits and offsets.

Plaintiff therefore prays for judgment in its favor against the United States of America for the sum of $100,571.25 representing the overpayment of income taxes for the period ending July 31, 1944, wrongfully and illegally withheld by defendant, plus interest as required by law, and for such other and further relief as to this Honorable Court seem just and proper.

JOHN C. WHITE,
838 Transportation Bldg.,
Washington 6, D. C.,
Attorney for Plaintiff.

9-10 *Duly sworn to by D. B. Canuafax. Jurat omitted in printing.*

11 In the United States Court of Claims

[Title omitted]

ANSWER—Filed February 27, 1953

The defendant herein, by its Assistant Attorney General, answers plaintiff's petition filed December 30, 1952, as follows:

1. Admits the allegations in paragraphs 1 and 2.

2. Alleges that it is without knowledge or information sufficient to form a belief as to the truth of the allegations of paragraphs 3 through 8 except to admit, as alleged in paragraph 7, "that upon his death M. D. Anderson held only 18,574 shares of the 31,000 originally issued to him."

3. Admits the allegations in paragraphs 9 through 12.

12 4. Denies the allegations in paragraph 13 except to admit that a typewritten report was prepared on May 21, 1947, by revenue agent W. C. Hammett, who recommended a deficiency of $89,337.66 which was based in part upon an inclusion in income of a long-term capital gain in the amount of $402,285, and admits that this report was accepted by the Commissioner of Internal Revenue, who assessed a deficiency of $89,337.66 with interest thereon of $14,396.82, a total of $103,734.48 which was paid on August 29, 1947. Defendant alleges that this assessment was made pursuant to a Waiver of Restrictions on Assessment and Collection of Deficiency in Tax on Treasury Form 870 which was signed by the taxpayer on May 21, 1947.

5. Admits the allegations in paragraphs 14 and 15 and admits that the claim for refund was filed on October 20, 1947.

6. Alleges that it is without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraphs 16, 18 and 19 except as stated in the paragraph next below.

7. Denies the allegations in paragraph 17 except to admit that the plaintiff's claim was rejected and also denies that the plaintiff is justly entitled to any portion of the amounts claimed in paragraph 19.

13-14 WHEREFORE, the defendant prays that the plaintiff take nothing from it in this suit, and that the petition be dismissed with costs against the plaintiff.

H. BRIAN HOLLAND,
Assistant Attorney General.

JOHN A. REES,
Attorney.

15 In the United States Court of Claims

[Title omitted]

[File endorsement omitted]

REPORT OF COMMISSIONER—Filed October 2, 1953

To the Honorable the CHIEF JUDGE AND ASSOCIATE JUDGES OF THE UNITED STATES COURT OF CLAIMS:

Pursuant to the order of reference in the above-entitled case the undersigned Commissioner makes the following report of his findings of fact:

1. The plaintiff, Anderson, Clayton & Co., is a corporation organized on December 31, 1929, and existing under the statutes of the State of Delaware with its principal business office at Houston, Texas.

2. Upon the organization of Anderson, Clayton & Co. in 1929, the corporation issued $25,842,375 of its 6½ percent preferred and 53,312½ shares of its common stock, the capital value of which was fixed at $1 per share, in exchange for 34,875 shares of the Texas joint stock association, also known as Anderson, Clayton & Co., and thereafter dissolved. On or about April 21, 1930, an additional 47,687½ shares of common were sold at $1 a share to the managing officials of the corporation resulting in the following total common stock ownership by the chief managing officials:

W. L. Clayton	44,800
M. D. Anderson	31,000
Lamar Fleming, Jr.	12,000
Harmon Whittington	5,000
D. B. Cannafax	2,750
L. L. Fleming	2,500
6 Minor Officials	1,950
	100,000

16 3. The original capitalization of the corporation, i.e., $25,842,375 of first preferred stock and $100,000 in common stock, was designed to have existing values represented by preferred stocks and to utilize the 100,000 shares of $1 common to adjust the participation of the managing officials in future earnings above the contracted return on first preferred.

4. Cotton merchandising is primarily a management business and is regarded as one of the most difficult and complex merchandising operations in the world. The results of a whole year's business

depend upon difficult day-to-day decisions by top executives as to the purchase and sale of spot cotton and the placement of hedges upon domestic and foreign futures exchanges. Long experience in all phases of the cotton business is almost essential to the success of a top cotton executive. It is difficult to obtain executives from other fields who can capably manage a cotton business.

5. The ownership of the common stock was surrounded with restrictions which were designed to insure its holding and use as a method of rewarding management. From the beginning it was understood by the common stockholders, all of whom were active in the business, that the stock was not salable outside the managing directors of the business, and that even within that group the disposition was to be made in accordance with the responsibilities of and contributions to management by the different executives as determined by the holders of at least 75 percent of the common stock. It was understood that no stockholder was entitled to sell his stock and none could keep it unless the others wanted him to. It was likewise understood from the beginning that the respective interests in the common stock would be adjusted among the managerial group as responsibility changed.

6. On February 14, 1931, an agreement in writing was entered into between the corporation and the holders of all its common stock, all of whom were actively engaged in the business. This instrument embodied, among other things, the provisions of the general understanding theretofore existing among the common stockholders with reference to the restrictions upon the holding of the stock and the plan for its use as a method of rewarding management. The agreement provided, in substance, that:

17

(1) All the common stockholders of the corporation agreed to endorse their common stock to Monroe D. Anderson as trustee for a period of 10 years.

(2) The stockholders retained the right to vote their stock.

(3) The stockholders agreed that they could not assign, transfer, or otherwise dispose of their common stock without the written consent of the holders of 75 percent of the stock.

(4) On the death of any party to the agreement, the corporation agreed to purchase the common stock of the deceased party at the value determined as of July 31, immediately preceding the death, according to the provisions made in the contract for the annual determination of value by the executive committee of the corporation, but in no event less than $1 per share, plus six percent interest from such date to the date of death.

(5) A consolidated balance sheet for the corporation and all its subsidiaries was to be prepared as of July 31 of each year (the end of its fiscal year); and, in addition, for the

private use of the individual parties to the agreement, a supplementary balance sheet, adjusted on account of appreciation and depreciation of the value of properties held by the corporation and its subsidiaries so as to reflect the true net worth of the corporation (without any allowance for good will), was also to be prepared and approved by the executive committee of the corporation as soon after the end of each fiscal year as practicable. The value of the common stock as shown in the supplementary balance sheet was to be fixed as the value of that stock for purposes of the contract.

(6) The owners of 75 percent of the common stock could at any time in writing request any party to the agreement to sell all or any part of his common stock to the corporation, or to such person as they might designate, upon terms agreeable to seller and buyer; and if seller and buyer could not agree, then according to the value fixed for the common stock in the annual supplementary balance sheet approved by the executive committee, as in the case of the death of any party to the contract.

(7) Any owner of common stock held by the trustee under the agreement could elect at any time to withdraw and sell his common stock to the corporation upon terms mutually
18 agreeable by giving written notice of his desire to the trustee. If the corporation and the party could not agree upon the selling price, then the value fixed in the annual supplementary balance sheet was to be used, substantially in the same way as in the case of death of a party.

(8) No dividends could be paid on common stock so long as the corporation was indebted in any sum whatever, nor in any event if the dividend would have the effect of lowering the book value of the stock below five million dollars as reflected in the consolidated balance sheet of the corporation, nor unless an amount of preferred stock equal to the dividend was retired at the same time.

(9) Any common stock purchased by the corporation under the terms of the agreement could be sold to the remaining parties to the agreement or to any other person whom the owners of 75 percent of the remaining stock might designate in writing.

(10) Any future holder of common stock could become a party to the agreement merely by signing it or giving his consent to its provisions in writing.

(11) All the parties to the agreement agreed that any common stock thereafter acquired by any of them, in whatever manner, should automatically be subject to all the terms of the agreement and should be endorsed to the trustee.

(12) The agreement could be amended, altered, revised, or

canceled at any time by an instrument in writing signed by the owners of 75 percent or more of the common stock.

7. Until the year ending July 31, 1937, the contract value of the common stock was, by authorization and declaration of dividends thereon in second preferred stock, maintained at approximately $1 a share, such course having been abandoned when the Commissioner sought to tax such stock dividends.

8. From time to time also as junior officials assumed more responsibilities and duties, shares of common stock were in pursuance of said agreement and in the ordinary course of business transferred by W. L. Clayton and M. D. Anderson to junior management officials so that upon his death M. D. Anderson held only 18,574 shares of the 31,000 originally issued to him.

9. All of the transfers of the corporation's common stock were made only to persons who occupied positions of managerial responsibility in the business and at the value determined under the agreement.

10. During its fiscal year ending July 31, 1944, Anderson, Clayton & Co., allocated and sold 6,500 shares of its common stock to the managing officials shown at the contracted valuation of $112.68 a share in recognition of increased responsibility and duties:

Names	Shares	Price
H. Whittington	2,000	$225,360
Sydnor Oden	1,250	140,850
W. H. Koar	1,500	169,020
J. M. Johnson	1,250	140,850
W. E. Parry	500	56,340
Total	6,500	732,420

11. The corporation received in payment the notes of the employees in the form approved by the directors. Counsel stipulated that the $112.68 received might, for the purposes of this case, be treated as though it were a cash sales price.

12. Of the officials to whom the corporation transferred 6,500 shares of the 18,574 purchased from the Estate of M. D. Anderson, Harmon Whittington was the vice-president in charge of trading policies and cotton merchandising activities; W. H. Koar, a vice-president in charge of the New York office and of relations with New York banks; Sydnor Oden, a vice-president in charge of cotton export sales; J. M. Johnson, a vice-president in charge of new plant and industrial activities; and W. E. Parry, the controller and chief accounting officer of the business.

13. The 6,500 shares of stock so allocated and sold was a part of the 18,574 shares acquired by the corporation on December 15,

1939, from the Estate of M. D. Anderson at its contracted valuation of $50.79 per share.

14. The difference between the amount of $330,136. paid the Estate of M. D. Anderson for 6,500 shares at $50.79 a share, its value at the time of the death of M. D. Anderson, in 1939, and $732,420, the price at which such stock was transferred to the managing employees mentioned in 1944 at $112.68 a share was credited by plaintiff to capital surplus and no income was reported for income tax purposes.

15. The effective certificate of incorporation of Anderson, Clayton & Co. authorized the issuance of 477,856 shares of stock, of which 300,000 shares, par value $100, was participating four percent cumulative first preferred, 75,000 shares, par value $100, was participating four percent cumulative second preferred stock, and 102,856 shares without nominal or par value was common stock. No preemptive rights existed as to common stock which could be issued at the discretion of the Board.

16. After four percent dividends on the preferred stocks were paid or set aside, the effective certificate of incorporation provided for the establishment of a "Common Stock Surplus" to consist of the undistributed surplus on July 31, 1938, less any unpaid accrued dividends on preferred, increased during each succeeding year by:

(1) Five Dollars per share on all Common Stock outstanding; and

(2) Four percent per annum on the Common Stock Surplus balance.

Any remaining undistributed surplus constituted "Participating Stock Surplus" which after payment of all cumulative preferred dividends and distribution of the entire "Common Stock Surplus" could be distributed as dividends, one-half to the Participating Preferred Stocks and one-half to Common.

17. Upon dissolution assets were distributable, first, to cover the par value and cumulative dividends of preferred stocks, then to common to cover the Common Stock Surplus and an amount of $1 per share, after which all remaining assets were divisible equally between preferred and common.

18. The agreement of February 14, 1931, was continued in effect during the taxable years involved by an instrument executed on April 16, 1943, extending its term until August 1, 1953. Such agreement provided that in case of death the value of the common stock for the purposes of the agreement should be $1 per share plus the proportionate interest of the stock in the Common Stock Surplus and Participating Stock Surplus determined by the Board of Directors as of the July 31st immediately preceding such death

plus four percent from such date to the date of death. It further provided that:

> 21 In determining such proportionate interest there shall be excluded from the common stock surplus the excess of cost of any shares of common stock held as treasury stock over $1.00 per share, and shares held as treasury stock shall be excluded from the total number of shares participating.

Any holder could be required to sell at such price upon request of 75 percent of the holders and upon withdrawal was entitled to payment for his stock at such price.

19. The balance sheet of the corporation as of July 31, 1943, approved by the Directors on November 30, 1943, showed the Capital Stock and Surplus of the corporation as follows:

Capital stock and surplus:

Participating 4% Cumulative preferred Stock, par value $100.00 per share:	
First preferred, 272,411 shares	$27,241,100.00
Second preferred, ~~54,411~~ 54441 shares	5,444,100.00
	32,685,200.00
Common stock, no par value, 84,083 shares	84,083.00
Surplus, per annexed statement	14,728,679.65
	47,497,962.65

20. The Common Stock Surplus as of July 31, 1943, was approved as follows:

Common stock surplus:

Balance at July 31, 1942		$5,079,070.03
Provision for cumulative $5.00 per share and 4% on balance	$623,352.80	
Less adjustment account 665 shares purchased	54,796.84	568,555.96
		5,647,625.~~00~~ .99

21. Valuation of the common stock as of July 31, 1943, was determined as follows:

Valuation of stocks:	
Preferred—326,852 shares outstanding, par value	$32,685,200.00
Participating surplus	4,497,212.96
Total value ($113.76 per share)	37,182,412.96
Common—84,083 shares outstanding, paid in value	$84,083.00
Common stock surplus	5,647,625.99
Participating surplus	4,583,840.70
Total value ($122.68 per share)	10,315,549.69

22. When the company bought the 18,574 shares of common stock held by M. D. Anderson at the contract price of $50.79 per share (i. e., the amended value of $48.33 as of July 31, 1938, plus interest to the date of his death), the cost over the $1 stated value of 15,539 shares was charged to Surplus-Allocated to Common Stock. The remaining 3,035 shares were sold on December 22, 1939, to W. L. Anderson at its July 31, 1939, valuation of $32.27 per share, and the loss of $18.52 a share or $56,208.20 was charged to Surplus-Allocated to Common Stock. When 1,000 shares were sold on February 28, 1941, at $33.62 a share Surplus was charged with the loss of $17,170.

23. Upon the sale of the 6,500 shares of common stock at $112.68 a share, such stock not participating in the dividend of $10 a share just previously declared on the 84,083 shares outstanding, Treasury Stock-Common was credited with the stated value of $6,500 and the excess of cost over stated value of the 6,500 shares sold in the sum of $309,526.16. Capital Surplus was credited with $725,920 the excess of the sales price over the $6,500 stated value.

24. At the time the Treasury stock was acquired, it was charged at cost, not at stated value, to "Treasury Stock-Common." To prepare balance sheet statements the difference between the stated value of the stock and its cost was set up in a reserve for valuation, and then the capital account was reduced by the stated value of the outstanding common stock as shown on the balance sheet. The cost of the stock over the stated value was charged to surplus; then when the stock was sold treasury stock was credited with its cost and the difference between cost and sales price was put into surplus as a loss or gain on treasury stock, common.

25. The common stock bought from shareholders was not can-

celled or retired but the shares outstanding less those held in the treasury were used in all financial statements, in the pay-
23 ment of dividends, in arriving at the per share values under the agreement. Treasury stock was not voted at meetings of shareholders nor taken into account in payment of dividends. During the taxable year involved there was no authorized unissued stock.

26. The stated $1 per share value of the common stock, which represented its capital under the laws of Delaware, was nominal and the substantial value of such stock was represented by the Common Stock Surplus and the Participating Surplus which amounted to $111.68 per share as of July 31, 1943, after deduction of the $10 dividend declared on November 30, 1943.

27. Under the certificate of incorporation and the common stockholders agreement and the method of accounting there required and consistently followed, the respective purchases and sales of common stock amounted in substance, in the case of purchases, to the withdrawal of earnings accumulated during the period of the ownership of such stock, and in the case of sales to new management to a deposit of an amount equal to accumulated earnings so as to equalize distributions during the ownership of such stock by the executive permitted to buy it.

28. The purchase of the 18,574 shares of the common stock from M. D. Anderson in 1939 was in conformity with the plan that the common stock should be held only by and sold only to active management. The purchase by the corporation was not for the purpose of investment or to deal in its common stock as it would the stock of another corporation. Under the stockholders agreement with the corporation such common stock could be sold only to persons and upon such terms as might be agreed upon in writing by the holders of 75 percent of the stock held by the trustee. Such stock could not be issued or transferred by the corporation until the stockholder executed acceptance of the agreement.

29. The sale of 6,500 shares of the common stock to various junior officials in December 1943, was to adjust the respective holdings in the common stock in accordance with responsibility and to reward managerial performance by the ownership of common stock which would keep cash in the business and compel the executives to acquire the proprietary interest deemed essential, and
not for the purpose of dealing in its stock as it would the
24-26 stock of another corporation.

30. Upon original issuance the corporation received $1 a share for its common stock, or $18,574, for the stock repurchased in 1939 from the M. D. Anderson estate. This repurchase of the 18,574 shares of common stock on December 15, 1939, at $50.79 a share from the M. D. Anderson estate reduced the assets of the

corporation by the amount of $943,373.46. The sale of 3,035 shares to W. L. Anderson on December 22, 1939, at $32.25 a share increased the net assets by $97,878.75, and the sale of 6,500 shares at $112.68 a share on November 30, 1943, increased the assets of the company by the amount of $732,420.

31. Following examination, the Commissioner of Internal Revenue determined that Anderson, Clayton & Co. realized a long-term capital gain in the amount of $402,285.00 on which the tax was $100,571.25 and with other adjustments determined a deficiency of $89,337.66, which was paid on August 27, 1947.

32. Claim for refund in the amount of $100,571.25 was executed October 18, 1947, and was filed by plaintiff on October 20, 1947.

33. On or about January 20, 1951, plaintiff received by registered mail an official notice, dated January 18, 1951, of disallowance of its claim of October 18, 1947.

Respectfully submitted,

WILSON COWEN,
Commissioner.

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In the United States Court of Claims

No. 626-52

ANDERSON, CLAYTON & CO. v. THE UNITED STATES

Mr. John C. White for plaintiff.

Mr. John A. Rees, with whom was *Mr. Assistant Attorney General H. Brian Holland*, for defendant. *Messrs. Andrew D. Sharpe* and *Lee A. Jackson* were on the brief.

OPINION—Decided July 13, 1954

LITTLETON, *Judge*, delivered the opinion of the court:

Plaintiff sues to recover $100,571.25 with interest thereon as provided by law. The principal sum represents the income tax assessed by the Commissioner of Internal Revenue and paid by plaintiff on the $402,285 difference between the amount at which plaintiff purchased 6,500 shares of its capital stock from a deceased official in 1939 and the amount at which it sold and reissued the stock to other officials during its fiscal year ending July 31, 1944. Plaintiff takes the position that no taxable long term capital gain resulted from the transaction because plaintiff was not dealing in the stock as it might have in the shares of another corporation, and that under the provisions of section 22 (a) of the Internal Revenue Code and section 29.22 (a)—15 of Treasury Regulation 111, all

the facts and circumstances surrounding the transaction show that no taxable gain arose to plaintiff.

Defendant contends that Regulation 111, section 29.22 (a)—15 does not entitle plaintiff to recover as that regulation has been construed by the Circuit Courts of Appeal for several circuits on facts sufficiently similar to the facts in this case to be persuasive.

Section 22 (a) of the Code provides:

> GENERAL DEFINITION.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

Regulation 111, section 29.22 (a)—15 provides:

> *Acquisition or disposition by a corporation of its own capital stock.*—Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.
>
> But if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of the Internal Revenue Code.

The facts as stipulated by the parties may be summarized as follows: Plaintiff was organized in 1929 as a cotton merchandising business with a capitalization of $25,842,375 of first preferred stock

and $53,312.50 of common stock. In 1930 an additional
29 46,687½ shares of common stock were sold at $1 per share, making the total common stock outstanding 100,000 shares. The capital value of the no par value common stock was fixed at a stated value of $1 per share and was sold at that price to the managing officials of the corporation. No preemptive rights existed as to the common stock.

Because of the complex nature of the cotton merchandising business and the essentiality of long experience for its top executives in all phases of the business, it was decided to use the common stock of the corporation as a means to attract, retain, and incite incentive in such top officials. In 1931 a written agreement was entered into between the corporation and the various company officials who owned all the common stock whereby each of the owners endorsed his stock to Monroe D. Anderson as trustee for a period of 10 years, which period was subsequently extended, with the stockholders retaining the right to vote the stock and receive dividends thereon. The agreement provided that the stockholders would not assign, transfer, or otherwise dispose of their stock without the written consent of the holders of 75 percent of the stock; that on the death of any party to the agreement the corporation would purchase the stock of the deceased person at the special book value determined as of July 31 immediately preceding the death according to the provisions contained in the agreement relative to the annual determination of value by the executive committee of the corporation, but in no event less than $1 per share, plus 6 percent interest from such date to the date of death. The value of the trusteed stock was to be determined annually from a supplementary balance sheet which had been adjusted to show appreciation and depreciation of the value of properties held by the corporation and its subsidiaries to reflect its true net worth. The owners of 75 percent of the stock could request any party to the agreement to sell all or part of his stock to the corporation or to such person as the owners of the 75 percent might designate, either upon terms agreeable to seller and buyer or in the absence of such agreement, at the value fixed for the stock in the annual supplementary balance sheet. Any owner of the stock could sell his stock to the corporation at any time upon the same terms. Any
30 common stock purchased by the corporation under the agreement could be sold to the remaining parties or to any other person whom the owners of 75 percent of the remaining stock might designate. A more complete summary of the agreement is set forth in finding 6.

As junior officials in the corporation assumed more responsibilities, W. L. Clayton, and M. D. Anderson who at first had owned the bulk of the trusteed stock, transferred shares of their stock to

such junior officals in accordance with the provisions of the agreement. At Mr. M. D. Anderson's death in 1939, he held only 18,574 shares of the 31,000 originally issued to him. All transfers of the stock were made to persons occupying positions of managerial responsibility in the business and at the values determined under the agreement.

Upon the death of Mr. Anderson, the plaintiff corporation purchased his 18,574 shares at the contract value of July 31, 1938, which with interest, amounted to $50.79 a share or a total of $943,373.46. The cost over the $1 stated value of 15,539 of these shares was charged to the Surplus Allocated to Common Stock account. The remaining 3,035 shares of this particular stock were sold to another company official in accordance with the agreement, based on the July 31, 1939, contract value of $32.27 a share and the net "loss" of $18.52 a share or $56,208.20 was charged directly to the Surplus Allocated to Common Stock account. This stock was not retired but was held as treasury stock. While in the treasury no dividends could be paid on it and it could not be voted. Also 1,000 of these shares were sold in 1941 at $33.62 a share and the $32,620 over stated value was credited to the Surplus Allocated to Common Stock account reflecting a "loss" of $17,170 on these shares. Although the corporation sold some of these shares for less than it had paid the deceased official's estate for them, this amount was not deducted from income but was reflected in Surplus as above stated, which resulted only in a smaller Surplus Allocated to Common Stock, maintaining the equity for all common stockholders equivalent to that existing before the sales.

In December 1943, the corporation and its stockholders decided to sell 6,500 shares of the Anderson Estate stock to five of the corporation's junior officials at $112.68 a share, which was the July 31, 1943, supplementary balance sheet value less a $10 dividend payable to the old common-stock holders. The amount over the $1 stated value was credited to the Capital Surplus account (plaintiff relabeled and consolidated some of its surplus accounts) and no income was reported. It is the difference, $402,285, between the amount paid the Anderson Estate in 1939 for the stock and the price at which the stock was trasnferred to the junior managing officials during the fiscal year ending July 31, 1944, that the Commissioner of Internal Revenue determined to be a taxable long-term capital gain. Timely claim for refund was made, and denied.

Plaintiff points out that under its certificate of incorporation and the trust agreement between itself and its common-stock holders, the transaction in question amounted in substance to the payment to the deceased stockholder of his capital contribution plus his share of undistributed earnings, and in the case of the sale to

the new officials, to the equalization of their capital investment with that of the other common-stock holders as represented by the outstanding shares before the sale. Plaintiff contends that when the real nature of the transaction is considered it certainly was not dealing in its own shares as it might in the shares of another corporation and that if the first and third sentences of the Regulation mean anything, they must have been intended to exclude from taxation any gain resulting therefrom.

Prior to 1934 the law on taxable gain or loss on the acquisition and sale of a corporation's own stock was relatively clear. The Commissioner's regulations provided that no gain or loss was realized from a corporation purchasing or selling its own stock.[1] This rule was reasonable, logical and in accord with the accountant's view.[2] The First Circuit in 1932, in its opinion in *Commissioner* v. *Woods Machine Co.*, 57 F. 2d 635, laid the groundwork for the Commissioner to make a complete about-face insofar as
32 the taxation of treasury stock was concerned. On May 2, 1934, T. D. 4430 [XIII-1 C. B. 36] was promulgated amending the regulations to provide, with certain exceptions not here material, as they do today. Although the retroactive application of the part pertinent herein of the regulation was held invalid by the Supreme Court, the Court did not decide whether its prospective application would be valid. *Helvering* v. *Reynolds Co.*, 306 U. S. 110. The validity of this regulation has been specifically sustained or assumed to be valid by the Circuit Courts[3] and this Court[4] al-

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[1] U. S. Treas. Reg. 45, Art. 542 (1918 Act); U. S. Treas. Reg. 62, Art. 543 (1921 Act); U. S. Treas. Reg. 65, Art. 543 (1924 Act); U. S. Treas. Reg. 69, Art. 543 (1926 Act); U. S. Treas. Reg. 74, Art. 66 (1928 Act); U. S. Treas. Reg. 77, Art. 66 (1932 Act).

[2] Paton, Accountant's Handbook (3rd ed.), pp. 1006-1014; Report of the Committee on Accounting Procedure (American Institute of Accountants 62 J. Accountancy 417 (1938); Security and Exchange Commission Accounting Series, Release No. 6 (1938).

[3] *Allen* v. *National Manufacture & Stores Corp.*, 125 F. 239, certiorari denied, 316 U. S. 679; *Aviation Capital* v. *Pedrick*, 148 F. 2d 165, certiorari denied, 326 U. S. 723; *Brown Shoe Co.* v. *Commissioner*, 133 F. 2d 582; *Commissioner* v. *Air Reduction Co.*, 130 F. 2d 145, certiorari denied, 317 U. S. 681; *Commissioner* v. *Batten, Barton, Durstine & Osborn, Inc.*, 171 F. 2d 474, certiorari denied 338 U. S. 816; *Commissioner* v. *Landers Corp.*, 210 F. 2d 188; *Commissioner* v. *H. W. Porter & Co.*, 187 F. 2d 939; *Commissioner* v. *Rollins Burdick Hunter Co.*, 174 F. 2d 698; *Dow Chemical Co.* v. *Kavanagh*, 139 F. 2d 42; *Helvering* v. *Edison Bros. Stores*, 133 F. 2d 575, certiorari denied, 319 U. S. 752; *United States* v. *Stern Bros. & Co.*, 136 F. 2d 488. Judge Frank, in a concurring opinion in

though apparently no real distinction can be made between the sale of unissued stock, which is unquestionably a capital transaction resulting in the realization of no income or loss, and the sale of treasury stock. Treasury stock is not subjected to as high a stamp tax, is nonassessable, and is free from preemptive rights and sales price restrictions. It may be noted in this respect that the common stock of plaintiff corporation was no-par-value stock and carried no preemptive rights on original issue. None of these distinctions appear relevant in determining whether the sale of treasury stock is a capital transaction. Insofar as the corporation is concerned the sale of unissued stock and the sale of treasury stock each involve a contribution of capital by the stockholder to the corporation with the corporation incurring the same obligation and duties to the stockholder, and the purchase of the stock for retirement and resale each involve a repayment of capital to the stockholder by the corporation. Cf. *E. R. Squibb & Sons* v. *Helvering*, 98 F. 2d 69. Also, treasury stock, like unissued stock, does not have an intrinsic value, but merely represents the power and right to issue additional stock. While in the treasury this stock earns
33 nothing for the corporation, dividends are not paid on it, nor does it carry voting or any of the other rights incident to outstanding stock. It would be a courageous step to hold that a corporation can never realize income on the sale of treasury stock because it is a capital transaction. We do not find it necessary to consider whether this step should be taken because the plaintiff is entitled to recover under the plain terms of the regulation as we construe it.

The Commissioner's position that income may be realized by a corporation on the sale of treasury stock may be justified on the ground that as a practical matter some corporations do deal in their own stock just as though it were an asset, buying it, holding it as an investment, and selling it at opportune times. That is the type of situation that we believe the portion of the regulation here in question covers.

The Tax Court, not withstanding reversals, has for a number of years uniformly applied this regulation literally and examined the real nature of the transaction considering all the facts and circumstances in determining whether or not the transaction resulted in a taxable gain. The Tax Court maintains the position

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Commissioner v. *Batten, Barton, Durstine & Osborn, Inc.*, *supra*, after stating that it was irrational to ever consider treasury stock as a capital asset said: "The situation then, to my mind, is like that in a farce: An untenable premise, once adopted, is to be carried out logically."

[4] *Wiegand Co.* v. *United States*, 104 C. Cls. 111.

that if a corporation buys and sells its own shares for the purpose of satisfying contractual obligations, equalizing shareholdings, eliminating a participant wishing to retire, implementing an employee profit sharing plan, or keeping the ownership of the corporation within a particular group, the corporation is not dealing in its own shares as it would in another corporation because the treasury shares are not treated as assets and are not bought and sold for the purpose of making a profit, and accordingly, holds that no taxable gain or loss is realized.[5]

The Circuit Courts of Appeal have, with equal uniformity, with some judges dissenting, adopted the position that unless the corporation repurchasing its own stock legally retires it according to State law and issues new stock, the transaction results in taxable gain or loss to the corporation.[6]

We agree with the Tax Court's position because: (1) we entertain some doubt as to whether a corporation's purchasing and selling its own stock is not really a capital transaction, (2) the basis for the Circuit Courts' decisions is one of form only in that it rests entirely on the failure of the corporation to go through the formal mechanics of actually retiring the stock and issuing new stock, and (3) the plain terms of the regulation support the Tax Court's position. When the regulation is viewed in this light, plaintiff falls comfortably within the language and purview of the regulation. The plaintiff did not purchase the stock at opportune times. It was obligated by contract to repurchase the stock when a stockholder died, at a price equal to the book value of the stock as determined from a supplementary balance sheet reflecting the true net worth of the corporation. This is how the stock in question was purchased by the corporation. The corporation was also obligated to purchase the stock of any common-stock holder who left the corporation, or for any reason withdrew from the agreement, at a negotiated price or in the event of their inability to agree, at the price determined similar to that of a deceased stockholder. The time of sale was clearly not dictated by profit on the sale of the stock. As a matter of fact some of the stock was sold at a "loss," and the approval of 75 percent of the common-

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[5] *Dr Pepper Bottling Co. of Miss.*, 1 T. C. 80; *Brockman Oil Well Cementing Co.*, 2 T. C. 168; *Cluett, Peabody & Co., Inc.*, 3 T. C. 169; *Rolling Burdick Hunter Co.*, 9 T. C. 169, rev'd 174 F. 2d 698; *Batten, Barton, Durstine & Osborn, Inc.*, 9 T. C. 448; *rev'd* 171 F. 2d 474; *H. W. Porter & Co.*, 14 T. C. 307, *rev'd* 187 F. 2d 939; *The Landers Corp.*, 11 T. C. M. 571, *rev'd* 210 F. 2d 188; *Timken-Detroit Axle Co.*, 21 T. C. No. 85 (decided Feb. 26, 1954).

[6] See footnote 3.

stock holders was required for these transactions. The provisions of the certificate of incorporation and the trust agreement were designed to attract, retain, and incite incentive in competent officials, which were a necessity because of the complex nature of its business. The common stock was trusteed under conditions that assured its receipt and retention by only active management and its redistribution according to changing managerial responsibility.

Pursuant to its certificate of incorporation and the trust agreement, plaintiff purchased Mr. M. D. Anderson's 18,574 shares at his death in 1939, for the contract value of $50.79 a share. In 1943, in accordance with plaintiff's policy, it sold 6,500 of these shares to junior officials of the corporation for $112.68 a share, which was the contract value less a $10 dividend payable to the old common-stock holders. This differential, which the Commissioner claims should be taxed, represents largely, if not entirely, accumulated earnings of the corporation which have already been subjected to tax. The respective purchases and sale of this common stock amounted in substance (1) in the case of purchases by the corporation, to the withdrawal by the stockholder of his capital contribution plus his undistributed earnings accumulated during the period of his ownership of such stock, and (2) in the case of sales by the corporation to new managers, to a contribution of capital in an amount equal to the existing stockholder's contributed capital plus accumulated undistributed earnings so as to equalize the equity of all common-stock holders and the distributions thereafter during the ownership of such stock by the executive permitted to buy it. On these facts it is rather difficult to comprehend how plaintiff corporation realized an accession to income. Upon examining the real nature of the transaction, considering all the facts and circumstances, we arrive at the conclusion that plaintiff was not dealing in its own shares as it might in the shares of another corporation.

The *Wiegand Co.* v. *United States* case, 104 C. Cls. 111, upon which defendant relies, is distinguishable on its facts.

Notwithstanding the uniformity of the decisions of the Circuit Courts on this issue, we are unable to agree with them. To say that there is a taxable gain merely because there is a difference between the purchase and sales price is really to assume the question in issue. There also can be a difference in the cost of stock retired and the price at which new stock is issued, but the resulting difference is not taxable or deductible because it is a capital transaction. Consequently, the question that confronts the court in these cases, assuming the regulation to be valid, is whether the treasury stock was treated in substance as an asset rather than stock of the corporation. To do this requires an examination of all the facts and circumstances of the case. Although the Circuit Court's view, considering the one factor of failing to actually retire the stock

as controlling, is an expeditious method of determining taxability of treasury stock, it must be conceded that this distinction between treasury stock and unissued stock is one of form. Moreover, it would be equally expeditious to hold that the acquisition and sale of a corporation's own stock was a capital transaction, since
36 it does as a practical matter result in readjustment of capital and find support in the famous case of *Eisner* v. *Macomber*, 252 U. S. 189. We therefore conclude that plaintiff is entitled to recover $100,571.25 plus interest allowed by law.

It is so ordered.

MADDEN, *Judge*; WHITAKER, *Judge*; and JONES, *Chief Judge*, concur.

Judge LARAMORE took no part in the consideration or decision of this case.

FINDINGS OF FACT

The court, having considered the evidence, the briefs and argument of counsel, and the report of Commissioner Wilson Cowen, makes the following findings of fact:

1. The plaintiff, Anderson, Clayton & Co., is a corporation organized on December 31, 1929, and existing under the statutes of the State of Delaware, with its principal business office at Houston, Texas.

2. Upon the organization of Anderson, Clayton & Co. in 1929, the corporation issued $25,842,375 of its 6½ percent preferred and 53,312½ shares of its common stock, the capital value of which was fixed at $1 per share, in exchange for 34,875 shares of the Texas joint stock association, also known as Anderson, Clayton & Co., which thereafter dissolved. On or about April 21, 1930, an additional 46,687½ shares of common were sold at $1 a share to the managing officials of the corporation resulting in the following total common stock ownership by the chief managing officials:

W. L. Clayton	44,800
M. D. Anderson	31,000
Lamar Fleming, Jr.	12,000
Harmon Whittington	5,000
D. B. Cannafax	2,750
L. L. Fleming	2,500
Six minor officials	1,950
	100,000

3. The original capitalization of the corporation, i. e., $25,842,375 of first preferred stock and $100,000 in common stock, was designed to have existing values represented by preferred stocks and

to utilize the 100,000 shares of $1 common to adjust the participation of the managing officials in future earnings above the
37 contracted return on first preferred.

4. Cotton merchandising is primarily a management business and is regarded as one of the most difficult and complex merchandising operations in the world. The results of a whole year's business depend upon difficult day-to-day decisions by top executives as to the purchase and sale of spot cotton and the placement of hedges upon domestic and foreign futures exchanges. Long experience in all phases of the cotton business is almost essential to the success of a top cotton executive. It is difficult to obtain executives from other fields who can capably manage a cotton business.

5. The ownership of the common stock was surrounded with restrictions which were designed to insure its holding and use as a method of rewarding management. From the beginning it was understood by the common-stock holders, all of whom were active in the business, that the stock was not salable outside the managing directors of the business, and that even within that group the disposition was to be made in accordance with the responsibilities of and contributions to management by the different executives as determined by the holders of at least 75 percent of the common stock. It was understood that no stockholder was entitled to sell his stock and none could keep it unless the others wanted him to. It was likewise understood from the beginning that the respective interests in the common stock would be adjusted among the managerial group as responsibility changed.

6. On February 14, 1931, an agreement in writing was entered into between the corporation and the holders of all its common stock, all of whom were actively engaged in the business. This instrument embodied, among other things, the provisions of the general understanding theretofore existing among the common-stock holders with reference to the restrictions upon the holding of the stock and the plan for its use as a method of rewarding management. The agreement provided, in substance, that:

(1) All the common-stock holders of the corporation agreed to endorse their common stock to Monroe D. Anderson as trustee for a period of 10 years.

38 (2) The stockholders retained the right to vote their stock.

(3) The stockholders agreed that they could not assign, transfer, or otherwise dispose of their common stock without the written consent of the holders of 75 percent of the stock.

(4) On the death of any party to the agreement, the corporation agreed to purchase the common stock of the deceased

party at the value determined as of July 31, immediately preceding the death, according to the provisions made in the contract for the annual determination of value by the executive committee of the corporation, but in no event less than $1 per share, plus six percent interest from such date to the date of death.

(5) A consolidated balance sheet for the corporation and all its subsidiaries was to be prepared as of July 31 of each year (the end of its fiscal year); and, in addition, for the private use of the individual parties to the agreement, a supplementary balance sheet, adjusted on account of appreciation and depreciation of the value of properties held by the corporation and its subsidiaries so as to reflect the true net worth of the corporation (without any allowance for good will), was also to be prepared and approved by the executive committee of the corporation as soon after the end of each fiscal year as practicable. The value of the common stock as shown in the supplementary balance sheet was to be fixed as the value of that stock for purposes of the contract.

(6) The owners of 75 percent of the common stock could at any time in writing request any party to the agreement to sell all or any part of his common stock to the corporation, or to such person as they might designate, upon terms agreeable to seller and buyer; and if seller and buyer could not agree, then according to the value fixed for the common stock in the annual supplementary balance sheet approved by the executive committee, as in the case of the death of any party to the contract.

(7) Any owner of common stock held by the trustee under the agreement could elect at any time to withdraw and sell his common stock to the corporation upon terms mutually agreeable by giving written notice of his desire to the trustee. If the corporation and the party could not agree upon the selling price, then the value fixed in the annual supplementary balance sheet was to be used, substantially in the same way as in the case of death of a party.

39 (8) No dividends could be paid on common stock so long as the corporation was indebted in any sum whatever, nor in any event if the dividend would have the effect of lowering the book value of the stock below five million dollars as reflected in the consolidated balance sheet of the corporation, nor unless an amount of preferred stock equal to the dividend was retired at the same time.

(9) Any common stock purchased by the corporation under the terms of the agreement could be sold to the remaining parties to the agreement or to any other person whom the

owners of 75 percent of the remaining stock might designate in writing.

(10) Any future holder of common stock could become a party to the agreement merely by signing it or giving his consent to its provisions in writing.

(11) All the parties to the agreement agreed that any common stock thereafter acquired by any of them, in whatever manner, should automatically be subject to all the terms of the agreement and should be endorsed to the trustee.

(12) The agreement could be amended, altered, revised, or canceled at any time by an instrument in writing signed by the owners of 75 percent or more of the common stock.

7. Until the year ending July 31, 1937, the contract value of the common stock was, by authorization and declaration of dividends thereon in second preferred stock, maintained at approximately $1 a share, such course having been abandoned when the Commissioner sought to tax such stock dividends.

8. From time to time also as junior officials assumed more responsibilities and duties, shares of common stock were in pursuance of said agreement and in the ordinary course of business transferred by W. L. Clayton and M. D. Anderson to junior management officials so that upon his death M. D. Anderson held only 18,574 shares of the 31,000 originally issued to him.

9. All of the transfers of the corporation's common stock were made only to persons who occupied positions of managerial responsibility in the business and at the value determined under the agreement.

10. During its fiscal year ending July 31, 1944, Anderson, Clayton & Co. allocated and sold 6,500 shares of its common stock to the managing officials shown at the contracted valuation of $112.68 a share in recognition of increased responsibility and duties:

Names	Shares	Price
H. Whittington	2,000	$225,360
Sydnor Oden	1,250	140,850
W. H. Koar	1,500	169,020
J. M. Johnson	1,250	140,850
W. E. Parry	500	56,340
Total	6,500	732,420

11. The corporation received in payment the notes of the employees in the form approved by the directors. Counsel stipulated that the $112.68 received might, for the purposes of this case, be treated as though it were a cash sales price.

12. Of the officials to whom the corporation transferred 6,500

shares of the 18,574 purchased from the Estate of M. D. Anderson, Harmon Whittington was the vice-president in charge of trading policies and cotton merchandising activities; W. H. Koar, a vice-president in charge of the New York office and of relations with New York banks; Sydnor Oden, a vice-president in charge of cotton export sales; J. M. Johnson, a vice-president in charge of new plant and industrial activities; and W. E. Parry, the controller and chief accounting officer of the business.

13. The 6,500 shares of stock so allocated and sold was a part of the 18,574 shares acquired by the corporation on December 15, 1939, from the Estate of M. D. Anderson at its contracted supplementary balance sheet valuation of $50.79 per share.

14. The difference, over stated value, between the amount of $330,135 paid the Estate of M. D. Anderson for 6,500 shares at $50.79 a share, its value at the time of the death of M. D. Anderson in 1939, and $732,420, the price at which such stock was transferred to the managing employees mentioned in 1944 at $112.68 a share was credited by plaintiff to Capital Surplus (plaintiff consolidated and relabeled some of its surplus accounts) and no income was reported for income tax purposes.

15. The effective certificate of incorporation of Anderson, Clayton & Co. authorized the issuance of 477,856 shares of stock, of which 300,000 shares, par value $100, was participating four percent cumulative first preferred, 75,000 shares, par value $100, was participating four percent cumulative second preferred stock, and 102,856 shares without nominal or par value was common stock. No preemptive rights existed as to common stock which could be issued at the discretion of the Board.

16. After four percent dividends on the preferred stocks were paid or set aside, the effective certificate of incorporation provided for the establishment of a "Common Stock Surplus" to consist of the undistributed surplus on July 31, 1938, less any unpaid accrued dividends on preferred, increased during each succeeding year by:

> (1) Five Dollars per share on all Common Stock outstanding; and
>
> (2) Four percent per annum on the Common Stock Surplus balance.

Any remaining undistributed surplus constituted "Participating Stock Surplus" which after payment of all cumulative preferred dividends and distribution of the entire "Common Stock Surplus" could be distributed as dividends, one-half to the Participating Preferred Stocks and one-half to Common.

17. Upon dissolution assets were distributable, first, to cover the par value and cumulative dividends of preferred stocks, then to common to cover the Common Stock Surplus and an amount of $1

per share, after which all remaining assets were divisible equally between preferred and common.

18. The agreement of February 14, 1931, was continued in effect during the taxable years involved by an instrument executed on April 16, 1943, extending its term until August 1, 1953. Such agreement provided that in case of death the value of the common stock for the purposes of the agreement should be $1 per share plus the proportionate interest of the stock in the Common Stock Surplus and Participating Stock Surplus determined by the Board of Directors as of the July 31st immediately preceding such death plus four percent from such date to the date of death. It further provided that:

> In determining such proportionate interest there shall be excluded from the common stock surplus the excess of cost of any shares of common stock held as treasury stock over $1.00 per share, and shares held as treasury stock shall be excluded from the total number of shares participating.
>
> Any holder could be required to sell at such price upon re-
> 42 quest of 75 percent of the holders and upon withdrawal was entitled to payment for his stock at such price.

19. The balance sheet of the corporation as of July 31, 1943, approved by the Directors on November 30, 1943, showed the Capital Stock and Surplus of the corporation as follows:

43 22. When the company bought the 18,574 shares of common stock held by M. D. Anderson at the contract price of $50.79 per share (i. e., the amended value of $48.33 as of July 1, 1938, plus interest to the date of his death), the cost over the $1 stated value of 15,539 shares was charged to Surplus-Allocated to Common Stock. The remaining 3,035 shares were sold on December 22, 1939, to W. L. Anderson at its July 31, 1939, valuation of $32.27 per share, and the difference between the $50.79 cost per share and the $32.27 selling price per share, or $56,208.20, was charged to Surplus-Allocated to Common Stock. When 1,000 shares were sold on February 28, 1941, at $33.62 a share Surplus Allocated to Common Stock was credited with $32,620 (the selling price over stated value, or $32.62 per share), which resulted in a net deficit of $17,170 for these 1,000 shares.

23. Upon the sale of the 6,500 shares of common stock at $112.68 a share, such stock not participating in the dividend of $10 a share just previously declared on the 84,083 shares outstanding, Treasury Stock-Common was credited with the stated value of $6,500 and the excess of cost over stated value of the 6,500 shares sold in the sum of $323,635 [$309,526.16 plus $14,108.84]. Capital Surplus was credited with $725,920, the excess of the sales price over the $6,500 stated value.

For the remainder of Finding No. 19 and Findings No. 20 & 21, see pages 12 & 13. (Omitted in error by printer)

24. At the time the Treasury stock was acquired, it was charged at cost, not at stated value, to "Treasury Stock-Common." To prepare balance sheet statements the difference between the stated value of the stock and its cost was set up in a reserve for valuation, and then the capital account was reduced by the stated value of the outstanding common stock as shown on the balance sheet. The cost of the stock over the stated value was charged to surplus; then when the stock was sold treasury stock was credited with its cost and the difference between cost and sales price was put into surplus.

25. The common stock bought from shareholders was not cancelled or retired but the shares outstanding less those held in the treasury were used in all financial statements, in the payment of dividends, in arriving at the par share values under the agreement. Treasury stock was not voted at meetings of shareholders
44 nor taken into account in payment of dividends. During the taxable year involved there was no authorized unissued stock.

26. The stated $1 per share value of the common stock, which represented its capital under the laws of Delaware, was nominal and the substantial value of such stock was represented by the Common Stock Surplus and the Participating Surplus which amounted to $111.68 per share as of July 31, 1943, after deduction of the $10 dividend declared on November 30, 1943.

27. Under the certificate of incorporation, the agreement between the corporation and its common-stock holders and the method of accounting there required and consistently followed, the respective purchases and sales of common stock amounted in substance, in the case of purchases by the corporation, to the withdrawal by the stockholder of earnings accumulated during the period of the ownership of such stock, and in the case of sales by the corporation to new managers to a contribution of capital in an amount equal to accumulated earnings so as to equalize the common equity of all stockholders and the distributions during the ownership of such stock by the executive permitted to buy it.

28. The purchase of the 18,574 shares of the common stock from M. D. Anderson in 1939 was in conformity with the plan that the common stock should be held only by and sold only to active management. The purchase by the corporation was not for the purpose of investment or to deal in its common stock as it would the stock of another corporation. Under the stockholders agreement with the corporation such common stock could be sold only to persons and upon such terms as might be agreed upon in writing by the holders of the 75 percent of the stock held by the trustee. Such stock could not be issued or transferred by the corporation until the stockholder executed acceptance of the agreement.

29. The sale of 6,500 shares of the common stock to various junior officials in December 1943, was to adjust the respective

holdings in the common stock in accordance with responsibility and to reward managerial performance by the ownership of common stock which would keep cash in the business and compel the executives to acquire the proprietary interest deemed essential,
45-46 and not for the purpose of dealing in its stock as it would the stock of another corporation.

30. Upon original issuance the corporation received $1 a share for its common stock, or $18,574, for the stock repurchased in 1939 from the M. D. Anderson estate. This repurchase of the 18,574 shares of common stock on December 15, 1939, at $50.79 a share from the M. D. Anderson estate reduced the assets of the corporation by the amount of $943,373.46. The sale of 3,035 shares to W. L. Anderson on December 22, 1939, at $32.27 a share increased the net assets by $97,939.45, and the sale of 6,500 shares at $112.68 a share on November 30, 1943, increased the assets of the company by the amount of $732,420.

31. Following examination, the Commissioner of Internal Revenue determined that Anderson, Clayton & Co. realized a long-term capital gain in the amount of $402,285.00 on which the tax was $100,571.25 and with other adjustments determined a deficiency of $89,337.66, which was paid on August 27, 1947.

32. Claim for refund in the amount of $100,571.25 was executed October 18, 1947, and was filed by plaintiff on October 20, 1947.

33. On or about January 20, 1951, plaintiff received by registered mail an official notice, dated January 18, 1951, of disallowance of its claim of October 18, 1947.

CONCLUSION OF LAW

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes that as a matter of law the plaintiff is entitled to recover.

It is therefore adjudged and ordered that plaintiff recover of and from the United States One Hundred Thousand Five Hundred Seventy-one Dollars and Twenty-five Cents ($100,571.25), with interest as provided by law.

47-48 PROCEEDINGS FOLLOWING OPINION OF THE COURT

On August 23, 1954, defendant filed a motion for a new trial or for a rehearing.

On October 5, 1954, the court entered the following order on said motion:

ORDER

These cases come before the court on motions for rehearings, amendment of judgments or new trials under Rules 53 and 54 of the Rules of this court and, on consideration thereof,

IT IS ORDERED this fifth day of October, 1954, that said motions be and the same are overruled as follows:

626-52 Anderson, Clayton & Co. Defendant's motion.

BY THE COURT.
(S) MARVIN JONES,
Chief Judge.

49 Clerk's Certificate to foregoing transcript omitted in printing.

50 IN THE UNITED STATES COURT OF CLAIMS

No. 626-52

ANDERSON, CLAYTON & CO., PLAINTIFF

v.

THE UNITED STATES, DEFENDANT

TRANSCRIPT OF TESTIMONY

Houston, Texas,
June 15, 1953,
Monday, at 10 a.m.

TESTIMONY FOR PLAINTIFF

The parties met, pursuant to notice of the Commissioner, at the time above stated, in Room 616, Federal Office Building, Houston, Texas.

Present:

Hon. WILSON COWEN, Commissioner;

APPEARANCES

JOHN C. WHITE, Esq., counsel for plaintiff;
JOHN A. REES, Esq., counsel for defendant.

On order of reference by the Honorable, the United States Court of Claims, in the above entitled cause, testimony on behalf of the plaintiff was taken as follows:

(The reporter was duly sworn by the Commissioner.)

Commissioner COWEN: We will come to order, now, Gentlemen. I would like to inquire first whether or not the parties have been able to stipulate at least a portion.

OFFERS IN EVIDENCE

Mr. WHITE: Yes, Mr. Commissioner. At first, I should say, perhaps, that Anderson, Clayton & Co. admits a number of the
51 allegations in the petition, then by work on Saturday, the counsel have reached certain agreement, and I would like to dictate those.

Commissioner COWEN: You may.

Mr. WHITE: Counsel agreed that you may include among the findings of fact the finding of the Tax Court in the case of Monroe D. Anderson, eighth Tax Court 706. Those findings were, in part, the basis of the petition and set out the general situation with respect to the stock involved here.

Based on a personal examination by respective counsel of original records maintained by the company, counsel further agreed that the following statements of fact are true:

1. That common stock held in the treasury was not voted in any meeting of stockholders nor taken into account in the payment of dividends.

2. That petitioner's first exhibit shows correctly the valuations placed on the common stock under the agreement.

I would like to offer that if I may.

Commissioner COWEN: It may be marked as plaintiff's exhibit no. 1.

(The document above referred to was marked Plaintiff's Exhibit No. 1 for identification.)

Mr. WHITE: That petitioner's exhibit, two shows correctly the transactions of the corporation in its common stock and the common price thereof.

52 Commissioner COWEN: It may be marked as Plaintiff's Exhibit No. 2.

(The document above referred to was marked Plaintiff's Exhibit No. 2 for identification.)

Mr. WHITE: Then I should like to offer the stockholders' agreement, as amended April 16, 1943, which was in effect as of the date of these transactions.

Commissioner COWEN: That may be marked as Plaintiff's Exhibit No. 3, being a document consisting of about eight pages plus the title sheet.

(The document above referred to was marked Plaintiff's Exhibit No. 3 for identification.)

Mr. WHITE: Then I wish to offer the consent of the common stockholders to the transfers of common stock involved in this transaction.

Commissioner COWEN: It may be marked as Plaintiff's Exhibit No. 4.

(The document above referred to was marked Plaintiff's Exhibit No. 4 for identification.)

Mr. WHITE: Then I should like to offer the agreement of merger of Anderson, Clayton & Co. of California into Anderson, Clayton & Co. of Delaware, which sets out the charter of the corporation in effect at the time of these transactions. I should like to be able to withdraw this and substitute a photostatic copy of
53 same.

Commissioner COWEN: It may be done. You understand you must forward it to the reporter before the reporter sends the transcriptions.

(Photostatic copy of the document above referred to is to be marked Plaintiff's Exhibit No. 5 for identification.)

Mr. WHITE: At this time I want to offer the minutes of meeting of the Directors of November 30, 1943, and this I want to supply to the reporter because it is being copied at the moment.

Commissioner: Yes, you will supply that in photostat or typewritten form. When received, that may be marked as Plaintiff's Exhibit No. 6.

(Photostatic copy of the document above referred to is to be marked Plaintiff's Exhibit No. 6 for identification.)

Commissioner COWEN: There being no exceptions, Mr. Rees, to Plaintiff's Exhibits?

Mr. REES: There are no objections.

Commissioner COWEN: Therefore, the exhibits of Plaintiff 1 to 6 inclusive are received in evidence.

(The documents above referred to, previously marked for identification as Plaintiff's Exhibits Nos. 1, 2, 3, 4, 5 and 6, are now received in evidence under the same numbers.)

Mr. WHITE: I want to call Mr. Cannafax to the stand.
54 Commissioner COWEN: Yes.

DUDLEY B. CANNAFAX, a witness produced by the plaintiff, having first been duly sworn by the Commissioner, was examined, and in answer to interrogatories, testified as follows:

Commissioner COWEN: Will you please state your name for the record.

The WITNESS: Dudley B. Cannafax.

Commissioner COWEN: Where do you reside now, Mr. Cannafax?

The WITNESS: No. 16, Sunset Boulevard, Houston.

Commissioner COWEN: All right, Mr. White, you may examine.

DIRECT EXAMINATION.

By Mr. WHITE:

1Q. Mr. Cannafax, will you please state your connection with Anderson, Clayton?

A. I am Vice-President and Treasurer at the present.

2Q. How long have you held that position?

A. That specific position, I suppose, from 1943.

3Q. And briefly what other positions have you held?

A. I was Managing Director of Anderson, Clayton & Co. Joint Stock Association from 1930 until its dissolution in 1943.

4Q. Did you have any function in connection with the agreement of the common stockholders of Anderson, Clayton & Co.?

A. I was a party to the agreement and I had that connection with it.

55 5Q. And after the death of Mr. Anderson, who was the trustee of that agreement?

A. I was.

6Q. I show you Petitioner's Exhibit No. 5, which is consent to the transfer of 6,500 shares involved, and ask you whether you were familiar with it.

A. Yes.

7Q. Are you familiar with the finding of fact of the Tax Court in docket in the Estate of Monroe B. Anderson, Eighth Tax Court number 706, page 706?

A. Yes.

8Q. Was the transfer referred to in the agreement before you made in accordance with and for the same purposes as those related in the finding of fact?

A. They were.

Mr. WHITE: That's all.

Commissioner COWEN: Just a minute, Mr. Cannafax.

Mr. Rees?

Mr. REES: No questions.

Commissioner COWEN: No questions. You may be excused, Mr. Cannafax. Thank you.

(Witness excused.)

Mr. REES: Mr. Commissioner, just to make certain the record covers one other fact that could be important, paragraph 9 of the

petition in this case refers to a sale of certain shares of
56 common stock by the taxpayer corporation at a contract evaluation of $112.68 a share. Counsel agreed that for the purpose of this case that $112.68 may be treated as though it were a cash sale price.

Commissioner COWEN: The same as the market value?

Mr. REES: No, the cash sale price. The record would otherwise show that part of that sum was covered by promissory notes, but those notes, of course were treated as being, and they were in fact, the same as face amount.

Commissioner COWEN: So it was the same as cash sale.

Mr. WHITE: Mr. Parry, please.

WILLIAM E. PARRY, a witness produced by the plaintiff, having been first duly sworn by the Commissioner, was examined, and in answer to interrogatories, testified as follows:

Commissioner COWEN: Mr. Parry, state your name.

The WITNESS: William E. Parry.

Commissioner COWEN: And where do you reside, Mr. Parry?

The WITNESS: 2407 Pelham Drive, Houston, Texas.

DIRECT EXAMINATION.

By Mr. WHITE:

1Q. Mr. Parry, will you state your position with Anderson, Clayton & Co.?

A. I am Controller of Anderson, Clayton.

2Q. What are your functions?

57 A. Supervising of all accounting, original books of record, tax auditing; the usual duties of the controller.

3Q. Are you familiar with the method of accounting which was made with respect to these transactions in the common stock of Anderson, Clayton & Co.?

A. I am.

4Q. Will you please state how they were handled, and in the statement refer to the records from which you are testifying.

A. May I get them?

Commissioner COWEN: Yes.

The WITNESS: Do you want me to start——

Commissioner COWEN: Perhaps you should offer for identification at least the records from which you will testify. Will you state what they are so they may be identified?

The WITNESS: Treasury stock common.

Commissioner COWEN: Mr. Parry, is that a sheet from your ledgers?

The WITNESS: Ledger sheet transactions related to the common treasury stock.

Mr. WHITE: May that be marked as Plaintiff's Exhibit 7?

Commissioner COWEN: It will be so marked.

(The document above referred to was marked Plaintiff's Exhibit No. 7 for identification.)

The WITNESS: Surplus account.

58 Mr. WHITE: That also is a sheet from your ledger?

The WITNESS: From the ledger, photostat. One or two sheets. One sheet, both sides.

Commissioner COWEN: What does that show, Mr. Parry?

The WITNESS: That shows the transactions and the totalling of the exchange of par value over cost.

Commissioner COWEN: That may be marked as Plaintiff's Exhibit 8.

(The document above referred to was marked Plaintiff's Exhibit No. 8 for identification.)

Mr. WHITE: Do you have a third exhibit?

The WITNESS: Yes, third exhibit is the ledger sheet surplus allocated to common stock.

Commissioner COWEN: Explain that a little, Mr. Parry, so we will understand what that shows.

The WITNESS: The Company had three classes of stock: first preferred, second preferred, having fixed rate of earnings. Then, after allocations of earnings in excess of those fixed rates, it was to go between common and the first and second preferred that were known as participating. They participate over the fixed rate after a certain part had been allocated to common. This—I don't know whether this is necessary or not.

Commissioner COWEN: That may be marked as Plaintiff's Exhibit No. 9.

(The document above referred to was marked Plaintiff's Exhibit No. 9 for identification.)

59 By Mr. WHITE:

Q. Then will you explain for the record, Mr. Parry, how these transactions are shown on your books, referring to those exhibits by number if you can.

Commissioner COWEN: He may want to look at them.

The WITNESS: At the time the treasury stock is acquired,—was acquired—it was charged at cost at the stated value and reduced to treasury stock, common. In preparing—For purposes of preparing balance sheet statements we would charge surplus and set up a re-

serve for valuation for the difference between the par value of the stock, one dollar, and what it had cost, and then we would deduct the capital, the treasury stock, from the issued stock to arrive at the stock as shows outstanding on our balance sheet. Of course, those surplus have been charged to surplus. When the stock was sold, we would take it out of treasury stock at the cost we had put it in and adjust this reserve and values and put the loss or gain into surplus as a loss or gain on treasury stock, common.

One of the first transactions—I don't knew whether you want this.

By Mr. WHITE:

6Q. Yes, I want to ask you how these excess in cost above the——

A. I was going to give you an example with a copy of the original voucher here.

60 7Q. All right, go ahead.

A. One of the first.—No, it wouldn't be one of the first either. The first sale of the treasury stock acquired from the estate of Mr. M. D. Anderson was to W. L. Anderson, 3,035 shares. This stock was purchased at $50.79 a share and sold for $32.27 a share, resulting in a loss of $18.52 a share. The total value—sale value—was $97,939.45.

This stock was paid for by surrendering first preferred stock, par value $26,500; second preferred stock, par value $55,600 in debentures, par value—face value—$15,800.00; and cash $39.45. The first and second preferred stocks were subsequently cancelled, retired.

8Q. How was the loss treated on your books?

A. The loss of $18.52 a share, or $56,208.20, was charged direct to surplus and treated as non-taxable income, or non-deductable expense in the income tax return for that year.

9Q. Were other transactions in which you had loss or gains on the transfer or sale of this treasury stock treated in a similar manner?

A. Yes, all transactions in treasury stocks in loss or gains were treated as direct surplus items and as not being taxable income or deductible expense.

10Q. The common stock that you bought from shareholders was never cancelled or retired?

A. No, but in the entire treatment—in all financial state-
61 ments, payment of dividends and everything—in arriving at the per share values under the agreement were based on the shares outstanding less the treasury stock, so for all intent and purposes it was retired.

(Discussion off the record.)

By Mr. WHITE:

11Q. Mr. Parry, are you familiar with the treatment on the books of these particular transactions in sixty-five—in the sale of 6,500 shares?

A. I am, definitely.

12Q. Do you have available and will you supply the reported photostatic copies of those actual ledger sheets?

A. Yes, I will.

Mr. WHITE: And may they be marked and received as Petitioner's Exhibits Nos. 10 and 11?

Commissioner COWEN: Yes, they may be marked and received as Plaintiff's Exhibits 10 and 11.

(Photostatic copies of the documents above referred to are to be marked Plaintiff's Exhibits Nos. 10 and 11 for identification.)

Commissioner COWEN: I think we ought to ask him how those particular transactions were handled, Mr. White.

By Mr. WHITE:

13Q. Yes, will you state how the profit you gained on those was handled?

A. This stock was bought at $50.79 and it sold for $112.68,
62 I believe it was.

14Q. Yes.

A. We gave notes. All of us gave notes. It was all by note. The notes were charged to notes receivable, employees, and the gain on the sale was credited to surpluses, direct to surplus, and treated as a non-taxable gain.

15Q. As a capital——

A. As a capital service.

Mr. WHITE: That's all I have, Mr. Commissioner.

The WITNESS: John, there will be three exhibits: surplus, treasury stock, and I think that year we divided all this into capital surplus. We set up a capital surplus.

Mr. WHITE: Instead of two additional exhibits, there will be three.

The WITNESS: Yes.

(Discussion off the record.)

Mr. WHITE: May we make that Petitioner's Exhibit 12?

Commissioner COWEN: Plaintiff's Exhibit No. 12.

(The document above referred to was marked Plaintiff's Exhibit No. 12 for identification.)

(Discussion off the record.)

CROSS EXAMINATION.

By Mr. REES:

1Q. Does the Exhibit No. 8 show the date of that first sale of 3,035 shares?

63 A. Yes, that shows December 22, 1939.

2Q. And that's before the period involved in this hearing?

A. Yes, that was just the—it was unusual to me because we got that much yet that little cash. But that's the first transaction in that stock.

3Q. Now, Mr. Parry, speaking and thinking entirely from an accounting standpoint without any regard to tax problems, tell us whether or not in your opinion the loss on that sale of 3,035 shares which was charged to surplus, tell us whether or not that loss on that sale of 3,035 shares which was charged to surplus was in any accounting or bookkeeping sense a true loss to the Company or purely a fictional transaction.

A. I would say it was a true loss, not strictly from accounting. Strictly from accounting, had the stock been retired they would have paid the extent of X dollars for the stock, and had they issued new stock they would have gotten less money for the new stock when they issued it, so the business in itself was out cash.

4Q. That was the answer I had in mind. The business was out cash.

A. To that extent.

5Q. Now, let's take one of the other transactions which occurred during the period involved in this suit for a transaction where a profit or a gain from an accounting standpoint was carried to the same surplus account, showing from an accounting viewpoint without any regard to a tax problem, was there in your opinion

64 any gain or profit or income to the Company in a true sense?

A. The Company's cash position improved.

6Q. Improved, yes. Thank you, that's the answer I had in mind.

A. Assuming you treat a note of that type as a cash transaction.

Mr. WHITE: Which we did.

By Mr. REES:

7Q. In other words, a stipulation between Mr. White and me this morning is a proper act?

A. Yes.

8Q. Now, during the period involved in this suit, were there any unissued shares of common stock held by the Company?

A. No, there wasn't. We had authorized up to July 31, '43, 120,000 shares opened.

Mr. WHITE: No, the charter which I offered, which Mr. Rees didn't have too much opportunity to examine, shows that there were outstanding issued number of shares authorized.

By Mr. REES:

9Q. Now, Mr. Parry, paragraph 12 in the petition before us today recites that no income was reported for federal tax purposes as having resulted from the transactions in the 6,500 shares of stock which were sold at a unit price larger than their unit cost.

Did you have anything to do with the preparation of the
65 tax return?

A. They are all prepared under my supervision and I approve them before they are properly signed.

10Q. In the preparation of those returns you did not report any income from these transactions?

A. No, sir, we treated it entirely as a surplus adjustment.

11Q. Do you know Mr. Hammett, a revenue agent sitting here this morning?

A. I do.

12Q. Do you know whether or not he later prepared an official report in connection with the question of income arising from these sales?

A. I believe he did. I don't know whether Mr. Hammett prepared them or not.

13Q. Do you know whether or not a report was prepared?

A. Yes.

14Q. And that resulted eventually in an assessment of additional taxes which the Company has paid?

A. Yes, sir.

15Q. Those were taxes involved in this suit?

A. Yes, sir.

16Q. And those taxes in this suit arise from the question of whether income did result from the sale of 6,500 shares?

A. Yes.

66 (Discussion off the record.)

Mr. WHITE: I believe that concludes our case, Mr. Commissioner.

Commissioner COWEN: All right.

And does the government have any proof here, Mr. Rees?

Mr. REES: I would like to have the revenue agent sworn, please, and ask him one or more questions.

67 In the United States Court of Claims

No. 626-52

ANDERSON, CLAYTON & CO., PLAINTIFF

v.

THE UNITED STATES, DEFENDANT

Houston, Texas
June 15, 1953,
Monday, at 10:45 a. m.

TESTIMONY FOR DEFENDANT IN REBUTTAL

The parties met, pursuant to agreement at the time above stated, in Room 616, Federal Office Building, Houston, Texas.

Present:

Hon. WILSON COWEN, Commissioner,
JOHN C. WHITE, ESQ., counsel for plaintiff;
JOHN A. REES, ESQ., counsel for defendant.

On order of reference by the Honorable, the United States Court of Claims, in the above entitled cause, testimony on behalf of the defendant in rebuttal was taken as follows:

(The reporter was previously sworn by the Commissioner.)

W. C. HAMMETT, a witness produced by the defendant, having first been duly sworn by the Commissioner, was examined, and in answer to interrogatories, testified as follows:

Commissioner COWEN: Mr. Hammett, state your name for the record.

The WITNESS: W. C. Hammett.

68 Commissioner COWEN: And Mr. Hammett, you are an agent of the—

The WITNESS: Internal Revenue Agent, 2740 Portsmouth.

Commissioner COWEN: All right, Mr. Rees.

DIRECT EXAMINATION.

By Mr. REES:

1Q. Mr. Hammett, the answer filed in this case in paragraph 4 states that a revenue agent, W. C. Hammett, prepared a typewritten report dated May 21, 1947, and that the report recommended a deficiency of $89.33786. Are you the gentleman who prepared that report?

A. I am.

2Q. Do you have that report before you?

A. I do.

3Q. Did you recommend the deficiency?

A. I recommended the deficiency, yes, sir.

4Q. Did that deficiency or additional tax result from your inclusion of any profit as income from the transaction in the 6,500 shares of common stock?

A. It did. Practically all of the deficiency resulted therefrom.

5Q. You have been present this morning and heard the testimony of witnesses and heard stipulations of counsel in the case?

A. I have.

69 6 Q. Is it—Is the deficiency which you recommended related to the same transactions that were discussed by the plaintiff's witnesses?

A. It is. There were other issues in the report, but that was the main issue.

7 Q. If you were now, today, preparing a new report or a revised report in this particular case and upon the knowledge that you have of the transactions as they have been presented to the Commissioner this morning, would your conclusion be the same or different from the conclusion that you set out in the report that you have before you?

A. It would definitely be the same.

8 Q. One other question, Mr. Hammett. I believe that actually the other issues in this report were those that resulted in a reduction in a deficiency attributable to this particular transaction.

A. That is correct.

Mr. REES: That is all.

Commissioner COWEN: All right, Mr. Hammett, you are excused.

(witness excused.)

Commissioner COWEN: Now, does the government have anything further?

Mr. REES: No, the government rests.

Commissioner COWEN: We will be in recess just a minute.

(short recess.)

Commissioner COWEN: Let the record show that all those
70 exhibits and the Plaintiff's No. 12 received in evidence, and that the proof of both parties in this case is closed.

(The documents above referred to, previously marked for identification as Plaintiff's Exhibits Nos. 7, 8, 9, 10, 11, and 12, are received in evidence under the same numbers.)

(Thereupon, at 10:55 a.m., the case was closed.)

71 Reporter's Certificate to foregoing transcript omitted in printing.

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PLAINTIFF'S EXHIBIT No. 1

Valuations of the Common Stock of Anderson, Clayton & Co. Under Stockholders Agreement

Date of Directors Meeting	Fiscal Year Ended July 31	
October 31, 1931	1931	$ 1.00
February 21, 1933	1932	1.00
October 4, 1933	1933	1.00
October 11, 1934	1934	1.0402
October 18, 1935	1935	1.00
May 14, 1937	1936	1.12
November 5, 1937	1937	13.02
October 21, 1938	1938	54.22*
October 25, 1939	1939	32.27
December 13, 1940	1940	33.62
December 9, 1941	1941	64.06
November 14, 1942	1942	79.60
November 30, 1943	1943	122.68
November 24, 1944	1944	140.43

* January 19, 1939 revised to $48.33.

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PLAINTIFF'S EXHIBIT No. 2

Transactions in Common Stock of Anderson, Clayton & Co.

Date	Purchased		Sold	
	Shares	Price[1]	Shares	Price
12-30-32	195	$ 1.00		
12-30-32			195	$ 1.00
6-13-34	2,600	1.00		
7-31-34			1,500	1.00
5- 1-35			1,100	1.00
12-15-39	18,574	48.33		
12-22-39			3,035	32.27
12-10-40	18	32.27		
12-27-40			1,000	33.62
7-31-41	1,275	33.62		
11-30-41	2,276	33.62		
1- 7-43	65	79.60		
1-14-43	300	79.60		
6-28-43	300	79.60		
12-18-43			6,500	112.68[2]

[1] Where provided interest was paid at the rate provided in the contract from the contract valuation date.

[2] Contract price $122.68 less $10.00 dividend paid prior to date of sale.

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PLAINTIFF'S EXHIBIT No. 3

Agreement Executed by the Corporation and the Holders of Its Common Stock, April 16, 1943.

75 THE STATE OF DELAWARE,
County of New Castle.

This AGREEMENT made and entered into by and between and among ANDERSON, CLAYTON & Co., a corporation incorporated under the laws of the State of Delaware, (hereinafter called "the corporation") nd the holders of its common stock outstanding on this date, for the purpose of modifying, reaffirming and continuing that certain trust and liquidation agreement heretofore entered into by and between Anderson, Clayton & Co., and the holders of its common stock, dated February 14, 1931, as amended and modified March 2, 1931, August 1, 1932, March 20, 1933, and October 20, 1933, so that the said agreement and amendments as herein modified, reaffirmed and continued shall, as a whole, hereafter read and be as follows, to-wit:

WITNESSETH:

I

The individual parties to this agreement, being the holders of all the common stock of said corporation, have heretofore delivered to D. B. Cannafax as trustee all of their respective shares of common stock of the corporation; endorsed in blank, to be held by said trustee from and after the date of such delivery until the first day of August, A.D. 1953, subject to the following covenants, agreements and conditions,—

(a) The said trustee or any successor trustee as herein provided for, shall issue a receipt to each stock holder whose stock is so deposited in the following form:

TRUSTEE'S RECEIPT

Receipt is acknowledged by the undersigned trustee of Certificate No. ——— for ——— shares of the common stock of Anderson, Clayton & Co., a Delaware corporation, issued in the name of ——— ——— and deposited by him, endorsed in blank, to be held in accordance with the provisions of
76 and subject to the terms and conditions of that certain agreement dated April 16, 1943, between Anderson, Clayton & Co., and the holders of its common stock.

Upon termination of the agreement and surrender of this receipt, certificate for the shares represented hereby and not theretofore transferred or purchased under the agreement will be delivered to the depositor.

Neither this receipt nor the shares for which it is issued may be negotiated, transferred or assigned except with the

written consent of the parties to said agreement as therein provided.

Dated this —— day of ——, 19——.

——————, Trustee.

(b) Except as herein provided, the individual parties hereto agree that they will not during the period covered by this agreement transfer or attempt to transfer and/or assign said stock held by said trustee or any part thereof or any interest therein, without the written consent of the corporation and the holders of at least seventy-five per cent of the stock held by the trustee under and by virtue of the terms of this agreement.

(c) If, during the period covered by this agreement, any stockholder, a party to this agreement, should die, all shares of common stock owned by such deceased party at the time of his death, and held by said trustee under the terms of this agreement, shall be purchased by the corporation for $1.00 per share plus the proportionate interest of said stock in the Common Stock Surplus and Participating Stock Surplus determined by the Board of Directors as of July 31st immediately preceding such death, plus four per cent (4%) per annum from such date to the date of death. In determining such proportionate interest there shall be excluded from the Common Stock Surplus the excess of cost of any shares of common stock held as treasury stock over $1.00 per share, and shares held as treasury stock shall be excluded from the total number of shares participating. In the event the deceased stockholder is indebted to the corporation, or any subsidiary thereof, the amount due hereunder shall be applied first to the payment or reduction of such indebtedness, and any remainder shall be paid to his estate in accordance with the following paragraph.

77 The corporation shall make payment for deceased party's stock in the following manner.—If the value of said stock determined in the manner hereinabove provided shall be less than $250,000.00, the whole of said amount shall be paid within six months after the death of said stockholder; if the value of said stock shall be more than $250,000.00, but not in excess of $500,000.00, $250,000.00 shall be paid within six months after the death of such deceased stockholder, and the remainder within twelve months after such death; if the value of said stock is in excess of $500,000.00, then $250,000.00 shall be paid within six months from the death of such stockholder and $250,000.00 each six months thereafter until the full amount is paid; provided, however, the corporation shall be permitted one full year (that is $500,000.00) in arrears without being adjudged in default, and that all deferred payments shall bear interest at the rate of four per cent (4%) per annum from date of death of such deceased stockholder until paid.

It is understood and agreed by and between the parties hereto that the aggregate of all sums which the corporation shall be required to pay under the terms hereof for the common stock of deceased and other stockholders purchased in accordance with this agreement, as hereinbefore and hereinafter provided, shall not exceed FIVE HUNDRED THOUSAND DOLLARS ($500,000.00) annually and where such corporation owes at one time unpaid purchase money on the stock of two or more such parties such payments shall be apportioned to the payment of the stock of the respective parties in proportion to the amount at that time owing on the stock of such respective parties. The corporation, however, reserves the right to pay the entire amount due for the interest of any stockholder, or any part thereof, on or before the maturity date thereof.

(d) If the corporation and the owners of seventy-five per cent or more of the stock held by the trustee in accordance with the terms hereof shall make written request of a party to this agreement so to do, such party requested shall sell, assign and transfer to the corporation, or to such person or persons as may be designated in such request, all or any part of his stock
78 so held in trust upon such terms and conditions as may be agreed upon by him and the corporation, or the person or persons purchasing such stock, and, if parties are unable to agree, then the corporation shall purchase such stock at the price and upon the same terms and conditions as herein provided for the purchase of such stock in case of the death of such party. It is understood and agreed that if such stockholder is indebted to the corporation or any subsidiary thereof the purchase price of such stock shall be applied to such indebtedness to the extent thereof whether such stock is purchased by the corporation or sold to some other person with its consent.

(e) Any owner of the common stock held by the trustee under this agreement may elect to withdraw at the succeeding July 31st, by serving written notice of his desire to do so upon the trustee and the corporation not less than thirty days before such date. Signed resignations of any officer or directorship held in the corporation or any subsidiary thereof shall accompany the notice to the corporation. In such event the corporation shall purchase such stock at such price and upon such terms and conditions as shall be agreed upon between the withdrawing stockholder and the corporation; and in the event of their inability to agree, then the stock shall be purchased upon the same terms and conditions provided herein for the purchase of the stock of a deceased stockholder except that the price shall be the value reflected in the balance sheet for said succeeding July 31st. The purchase price of said stock shall be applied first to the payment of any indebt-

edness due by the seller to the corporation or any subsidiary thereof.

This provision shall be suspended during any period in which liquidation or dissolution is being actively considered by the directors or stockholders; and upon receipt of written notice of withdrawal of any stockholder, the directors of the corporation may and if as much as twenty-five per cent of the common stock outstanding is covered by such withdrawal notice or notices, shall, call a meeting of the stockholders within a reasonable time to consider the question of liquidation or dissolution; and no agree-
79 ment for the purchase of the stock of a withdrawing stockholder shall be concluded unless the stockholders decide against such liquidation or dissolution. If liquidation or dissolution is decided upon, then the common stock of the withdrawing stockholder shall receive the amount to which it is entitled under the certificate of incorporation.

This right shall also be suspended during any period in which purchase of the stock, if retired, would result in the impairment of the capital of the corporation.

II

All the individual parties hereto agree, bind and obligate themselves in the event it becomes necessary to do so to vote all shares of stock owned by them in the corporation, so as to authorize, empower and direct the officers of the corporation to carry out its part of this agreement. On all matters not incident in any way to this contract each individual party to this agreement shall be at liberty to cast the vote to which the stock owned by him and held in trust under the terms hereof is entitled in a manner deemed advisable by him.

III

The common stock of any of the parties hereto purchased by the corporation under the terms hereof may be sold and distributed to the remainder of the parties hereto or to any other person, firm or corporation in such manner and on such terms as may be agreed upon in writing by the corporation and the parties hereto owning at least seventy-five per cent of the remainder of said stock held by said trustee under and by virtue of the terms hereof.

IV

It is also agreed and understood that any future holder of common stock of the corporation shall become a party to this agreement by signing same or by a written acceptance of all of the provisions, terms, and conditions of same, and when same is
80 signed or so accepted by any future holder of the common stock he shall be considered an original party to this agree-

ment as though he were one of the holders of the common stock on the date of this agreement and one of the original signers of same, and this agreement shall be just as binding upon such stockholder and the stock delivered by him to the trustee, and upon the corporation, as though he were one of the original parties to this agreement. It is also agreed and understood by the parties hereto and all other persons hereafter becoming a party to this agreement that any common stock of the corporation hereafter acquired by any such party whether in the way of stock dividend, increase in capital stock, purchase or otherwise shall automatically be subject to the terms of this agreement, and that such party will forthwith endorse and deliver same to the trustee to be held under and subject to the terms hereof and the Secretary of the company in issuing any such stock is charged with the duty of seeing that this provision of agreement is complied with. It is further understood and agreed that no common stock will be issued or transferred by the corporation, until the holder to whom it is to be issued or transferred shall have signed, in duplicate, a written acceptance of the provisions, terms and conditions of this agreement in the following form:

STOCKHOLDERS ACCEPTANCE OF AGREEMENT

The undersigned hereby accepts and agrees to the provisions, terms and conditions of the agreement of April 16, 1943, between Anderson, Clayton & Co., and the holders of its common stock, and any amendments thereto adopted, and such agreement, and any amendments thereto, shall be binding upon the undersigned, his heirs and assigns.

Dated this —— day of ——, 19——.

_____,

Stockholder.

_____,

Witness.

V

The corporation and the owners of seventy-five per cent or more of the stock on deposit with the trustee may at any time
81 by instrument in writing signed by them remove the incumbent trustee and appoint a successor trustee; and in the event of the death, resignation, or disability of the trustee, the President of the corporation shall be the successor trustee hereunder until the corporation and the owners of seventy-five per cent or more of the stock on deposit have designated a successor trustee in writing. Any successor trustee shall succeed to all the

duties and obligations and be possessed of all the powers, rights and authority of the original trustee hereunder.

VI

This contract may be amended, altered, revised or cancelled at any time by an instrument in writing signed by the corporation and by individual parties hereto owning seventy-five per cent or more of the stock held by the trustee, as trustee under and by virtue of the terms of this agreement, but the said contract cannot be so altered or amended in any manner affecting the interests of a deceased stockholder.

VII

Wherever in this contract there occurs the expression "holders of seventy-five per cent of the stock held by the trustee" or words of similar import the expression shall be considered as embracing only those stockholders who have signed this agreement and other stockholders who have become additional parties to this agreement by signing the written acceptance thereof, and the expression shall not be construed as including the heirs, executors, administrators or personal representatives of any deceased stockholder whose stock is acquired by the corporation upon his death.

VIII

This agreement is executed in duplicate originals of equal dignity and it is agreed that one of same shall be kept by the trustee and the other shall be kept by the corporation; and it is further agreed that upon request of any stockholder, a party hereto, the Secretary of the corporation shall furnish one certified copy of this agreement, but only for the private and confidential use of such stockholder.

82-83 IX

This agreement is being executed under and in accordance with the provisions of paragraph VIII of aforesaid original agreement and when executed by the corporation and the parties owning at least seventy-five per cent of the common stock of said corporation held by the trustee as trustee under the terms of said original agreement, the same shall be substituted for said original agreement and shall become effective and binding on all parties owning said common stock so held by said trustee.

EXECUTED as of the 16th day of April, A. D. 1943.

Attest:
W. F. HIGGINS,
Secretary.

ANDERSON, CLAYTON & CO.
By W. H. KOAR,
President.

W. L. CLAYTON
H. WHITTINGTON
SYDNOR ODEN
J. M. JOHNSON
W. E. PARRY
A. N. HILBURN
C. T. DONLIN
WILLIAM J. JUNG
R. C. GREGG
C. C. HIGHTOWER
J. ROSS RICHARDSON
WALLACE FLEMING,
W. F. HIGGINS,
Atty.
PAUL J. FICHTER,
W. F. HIGGINS,
Atty.
T. O. SCHMID,
W. F. HIGGINS,
Atty.

LAMAR FLEMING, JR.
D. B. CANNAFAX
W. H. KOAR
JOHN C. WHITE
C. O. LAMBERTH
ALSTON CLAPP, SR.
J. P. FUESLER
W. LELAND ANDERSON
H. B. POTTS
FRANK C. ANDERSON,
JAMES E. ANDERSON
W. F. HIGGINS,
Atty.
FRED COCKRELL,
W. F. HIGGINS,
Atty.
C. S. RUFF,
W. F. HIGGINS,
Atty.
J. E. WADDELL,
W. F. HIGGINS,
Atty.

84 PLAINTIFF'S EXHIBIT NO. 4

CONSENT

WHEREAS Anderson, Clayton & Co., a corporation organized under the laws of Delaware, and the holders of its common stock are parties to that certain agreement dated April 16, 1943, governing the holding and disposition of the common stock of the corporation, and

WHEREAS paragraph (b) of Section I of said agreement provides:

> "Except as herein provided, the individual parties hereto agree that they will not during the period covered by this agreement transfer or attempt to transfer and/or assign said stock held by said trustee or any part thereof or any interest therein, without the written consent of the corporation and the holders of at least seventy-five per cent of the stock held by the trustee under and by virtue of the terms of this agreement."

NOW, THEREFORE, the undersigned Anderson, Clayton & Co., and the holders of more than seventy-five per cent of the common stock

of the corporation hereby confirm consent heretofore given to the sale and transfer out of the Treasury of the company of Six Thousand Five Hundred (6,500) shares of the common stock, as follows:

To:	H. Whittington	2,000 shares
	W. H. Koar	1,500 shares
	Sydnor Oden	1,250 shares
	J. M. Johnson	1,250 shares
	W. E. Parry	500 shares
		6,500 shares

SIGNED IN DUPLICATE ORIGINAL this 18th day of December, 1943.

ANDERSON, CLAYTON & CO.
By LAMAR FLEMING, JR.,
President.

W. L. CLAYTON
LAMAR FLEMING, JR.
H. WHITTINGTON
D. B. CAMAFAX
SYDNOR ODEN
W. H. KOAR
J. M. JOHNSON

Signed in duplicate original this 18th day of December, 1943.

W. L. CLAYTON
LAMAR FLEMING, JR.
H. WHITTINGTON
D. B. CANNAFAX.

ANDERSON, CLAYTON & CO.
By LAMAR FLEMING, JR.
President.

SYDNOR ODEN
W. H. KOAR
J. M. JOHNSON

85 PLAINTIFF'S EXHIBIT NO. 5

AGREEMENT OF MERGER

of

ANDERSON, CLAYTON & CO.,
a corporation of the State of California

INTO

ANDERSON, CLAYTON & CO.,
a corporation of the State of Delaware

Agreement of merger made and entered into this 16th day of September, A. D. 1943, by and between Anderson, Clayton & Co., a corporation organized and existing under the laws of the State of Delaware, party of the first part, and Anderson, Clayton & Co., a corporation organized and existing under the laws of the State of California, party of the second part.

Whereas, said Anderson, Clayton & Co., party of the first part, has heretofore been duly organized under and by virtue of the General Corporation Law of the State of Delaware, the certificate of incorporation of which corporation was filed in the office of the Secretary of State on the 31st day of December, 1929, and recorded in the office of the Recorder of Deeds for the County of New Castle on the 31st day of December, 1929, and amendments to which certificate of incorporation were filed in the office of the said Secretary of State and recorded in the office of said Recorder of Deeds on the following dates:

Filed		Recorded	
April	14, 1930	April	14, 1930
December	7, 1931	December	7, 1931
October	19, 1933	October	19, 1933
January	8, 1937	January	8, 1937
December	22, 1938	December	22, 1938

and certificates of retirement of ~~preferred stock~~ of which company were filed and recorded on March 17, 1933, January 12, 1935, January 29, 1937, August 1, 1938, and September 3, 1943, and a Certificate of Reduction of capital of which Company was filed and recorded on December 22, 1938; and

86 Whereas, the principal office of said Anderson, Clayton & Co., party of the first part, in the State of Delaware is located at No. 100 West Tenth Street, in the City of Wilmington, County of New Castle, and the name and address of its resident agent is ~~The Corporation Trust Company, No. 100 West Tenth~~ Street; in said City; and

Whereas, said party of the first part has an authorized capital stock consisting of Four Hundred Seventy Eight Thousand and Six (478,006) shares, divided into Three Hundred Thousand shares of Participating Four Per Cent Cumulative First Preferred Stock of the par value of One Hundred Dollars ($100) each, amounting in the aggregate to Thirty Million Dollars ($30,000,000), Seventy Five Thousand shares of Participating Four Per Cent Cumulative Second Preferred Stock having a par value of One Hundred Dollars ($100) per share, amounting in the aggregate to Seven Million Five Hundred Thousand Dollars ($7,500,000), One Hundred Fifty (150) shares of Five Per Cent Cumulative Second Preferred Stock having a par value of One Hundred Dollars ($100) per share, amounting in the aggregate to Fifteen Thousand Dollars ($15,000), and One Hundred Two Thousand Eight Hundred Fifty Six (102,856) shares of Common Stock without nominal or par value, of which capital stock Two Hundred Seventy Three Thousand Six Hundred Seventy Six (273,676) shares of Participating Four Per Cent

Cumulative First Preferred Stock, Fifty Four Thousand Five Hundred Eighty Seven (54,587) shares of Participating Four Per Cent Cumulative Second Preferred Stock, and One Hundred Two Thousand Eight Hundred and Fifty Six (102,856) shares of Common Stock are now issued and outstanding; and

Whereas, said Anderson, Clayton & Co., party of the second part, has heretofore been duly organized under and by virtue of the laws of the State of California, the Articles of Incorporation of which corporation were filed in the office of the Secretary of State on the 26th day of July, 1935, and

87 Whereas, said Anderson, Clayton & Co., party of the second part, has an authorized capital stock consisting of One Thousand (1,000) shares of Common Stock, having a par value of One Hundred Dollars ($100) per share, amounting in the aggregate to One Hundred Thousand Dollars ($100,000), of which capital stock One Thousand (1,000) shares are now issued and outstanding; and

Whereas, the principal office of said Anderson, Clayton & Co., party of the second part, in the State of California is in the City of Los Angeles, County of Los Angeles; and

Whereas, Anderson, Clayton & Co., party of the first part, is the owner of all of the outstanding stock of Anderson, Clayton & Co., party of the second part; and

Whereas, the Board of Directors of each of said corporations parties hereto, to the end that greater efficiency and economy in the management of the business carried on by each corporation may be accomplished, does deem it advisable and generally to the advantage and welfare of said corporations and their respective stockholders that such corporations merge into a single corporation under and pursuant to the provisions of the General Corporation Law of the State of Delaware;

Now, Therefore, in consideration of the premises and of the mutual covenants, agreements, provisions and grants hereinafter contained, it is hereby agreed by and between the parties hereto and in accordance with the General Corporation Law of the State of Delaware and the laws of the State of California, as follows:

(1) Said Anderson, Clayton & Co., party of the second part, shall be and the same is hereby merged into Anderson, Clayton & Co., party of the first part, which single surviving corporation is organized under the General Corporation Law of Delaware.

(2) The terms and conditions of such merger and the method of carrying same into effect and the manner of converting the shares of stock of said Anderson, Clayton & Co., party of the

second part, into shares of such surviving corporations are
88 as follows:

FIRST: The name of said surviving corporation (hereinafter termed the Corporation) is Anderson, Clayton & Co. The corporation shall be governed by the General Corporation Law of the State of Delaware.

SECOND: The principal office of the Corporation in the State of Delaware is to be located at No. 100 West Tenth Street, in the City of Wilmington, County of New Castle, and the name and address of its resident agent is The Corporation Trust Company, No. 100 West Tenth Street, Wilmington, Delaware.

THIRD: The nature of the business and the objects and purposes to be transacted, promoted or carried on by the Corporation are:

To purchase, sell, store, distribute, export and process cotton, cotton linters, cottonseed and cottonseed products in the United States and foreign countries and engage in any other activities related thereto;

To manufacture, purchase or otherwise acquire, own, mortgage, pledge, sell, assign and transfer, or otherwise dispose of, to invest, trade, deal in and deal with, goods, wares and merchandise and real and personal property of every class and description;

To subscribe for, purchase, acquire, hold, sell, exchange, pledge, hypothecate, or otherwise dispose of or deal in, the shares of stock, bonds, debentures, notes or other certificates or evidences of indebtedness, and obligations of any person, persons, firm, co-partnership or association, or of any private, public, quasi-public, or municipal corporation, domestic or foreign, or of any domestic or foreign state, government or governmental authority, or of any political or administrative subdivision or department thereof, and all trust, participation or other certificates of, or receipts evidencing interest in any such securities, and, while the owner of any such shares of stock, bonds, debentures, notes or other certificates or evidences of indebtedness or interest therein, to exercise all the rights, powers and privileges of ownership, including the right to vote thereon for any and all purposes;

To buy, purchase, or otherwise acquire, and to hold, cancel, retire, re-issue, or otherwise dispose of the shares of the capital stock, bonds, debentures, notes and other obligations of this Corporation, from time to time, to such extent, at such price, and in such manner and upon such terms, as the board of directors of this Corporation shall from time to time determine, provided that shares of its own capital stock belonging to it shall not be voted directly or indirectly;

To apply for, purchase or in any manner to acquire, and to hold, own, use, and operate and to sell or in any manner dispose of, and to grant licenses and other rights in respect of, and in any manner deal with, any and all rights, inventions, improvements and processes used in connection with or secured under letters patent or copyrights of the United States, or other countries, or otherwise, or otherwise to work, operate or develop the same, and to carry on any business, manufacturing or otherwise, which may directly or indirectly effectuate these objects or any of them;

89 To purchase, lease or otherwise acquire and to hold, own, sell or dispose of real and personal property of all kinds and in particular lands, buildings, business concerns and undertakings, shares of stock, mortgages, bonds, debentures, notes and other securities, merchandise, book debts and claims, trademarks, trade names, patents and patent rights, copyrights and any interests in real or personal property;

To borrow money for its corporate purposes, and to make, accept, endorse, execute and issue promissory notes, bills of exchange, bonds, debentures or other obligations from time to time, for the purchase of property or for any purpose in or about the business of the Corporation, and, if deemed proper, to secure the payment of any such obligations by mortgage, pledge, deed of trust or otherwise;

To acquire (by purchase for cash, through issuance and/or exchange of securities, or otherwise) and to take over as a going concern and thereafter to carry on the business of any person, firm or corporation engaged in any business which this corporation is authorized to carry on, and in connection therewith, to acquire the good will and all or any of the assets and to assume or otherwise provide for all or any of the liabilities of any such business;

To sell, improve, manage, develop, lease, mortgage, dispose of or otherwise turn to account or deal with all or any part of the property of the Corporation;

To do all and every thing necessary, suitable and proper for the accomplishment of any of the purposes or the attainment of any of the objects or the furtherance of any of the powers hereinbefore set forth, either alone, or in association with other corporations, firms, or individuals, and to do every other act or acts, thing or things incident or appurtenant to or growing out of or connected with the aforesaid business or powers or any part or parts thereof, provided the same be not inconsistent with the laws under which this Corporation is organized;

To have one or more offices, to carry on all or any of its

operations and business and without restriction or limit as to amount to purchase or otherwise acquire, hold, own, mortgage, sell, convey, or otherwise dispose of, real and personal property of every class and description in any of the States, Districts, Territories or Colonies of the United States, and in any and all foreign countries, subject to the laws of such State, District, Territory, Colony or Country.

To do any and all things herein set forth, and in addition such other acts and things as are necessary or convenient to the attainment of the purposes of this Corporation, or any of them, to the same extent as natural persons lawfully might or could do in any part of the world, insofar as such acts are permitted to be done by a corporation organized under the General Corporation Laws of the State of Delaware.

The foregoing clauses shall be construed both as objects and powers, and it is hereby expressly provided that the foregoing enumeration of specific powers shall not be held to limit or restrict in any manner the powers of this Corporation and are in furtherance of, and in addition to, and not in limitation of the general powers conferred by the laws of the State of Delaware.

It is the intention hereof that the purposes, objects and powers specified in this Article Third and all subdivisions thereof shall, except as otherwise expressly provided, in no wise be limited or restricted by reference to or inference from the terms of any other clause or paragraph of this
90 Article, and that each of the purposes, objects and powers specified in this Article Third shall be regarded as independent purposes, objects and powers.

FOURTH: The total number of shares that may be issued by the Corporation is Four Hundred Seventy Seven Thousand Eight Hundred and Fifty Six (477,856) of which Three Hundred Thousand (300,000) shares of a par value of One Hundred Dollars ($100) per share, amounting in the aggregate to Thirty Million Dollars ($30,000,000), shall be designated Participating Four Per Cent Cumulative First Preferred Stock; Seventy Five Thousand (75,000) shares of a par value of One Hundred Dollars ($100) per share, amounting in the aggregate to Seven Million Five Hundred Thousand Dollars ($7,500,000), shall be designated Participating Four Per Cent Cumulative Second Preferred Stock; and One Hundred and Two Thousand Eight Hundred and Fifty Six (102,856) shares without nominal or par value shall be designated Common Stock. The powers, preferences and rights and the qualifications, limitations, or restrictions of the classes of stock

hereinbefore designated, the fixing of which by this agreement of merger is desired, are as follows:

The holders of Participating Four Per Cent Cumulative First Preferred Stock and the holders of Participating Four Per Cent Cumulative Second Preferred Stock shall be entitled to receive, payable when and as declared from the surplus or net profits of the Corporation, dividends at the rate of four per centum (4%) per annum, which shall accrue annually on the thirty first day of July; provided that no dividend shall be declared or paid on the Participating Four Per Cent Cumulative Second Preferred Stock except after all accrued cumulative dividends on Participating Four Per Cent Cumulative First Preferred Stock have been declared and paid, or provided for.

The dividends on the Participating Four Per Cent Cumulative First Preferred Stock and upon the Participating Four Per Cent Cumulative Second Preferred Stock shall be cumulative and shall be declared and paid or provided for before any dividends on
91 the Common Stock shall be declared, or paid, and if not declared and provided for as they accrue, there shall be added to the amount of such dividends a sum equivalent to interest thereon to the date payment is available at a rate per annum the same as the annual rate of dividend, compounded on each succeeding dividend payment date, so that, if in any year any part of the cumulative dividends on any preferred stock of any class shall not have been provided for, the deficiency plus an amount equivalent to interest as aforesaid shall be declared and paid, or provided for, before any dividends shall be declared or paid upon the Common Stock; and no dividends shall be declared or paid on Common Stock and no joint participating dividend as hereinafter defined shall be declared or paid on common and participating preferred stock unless the sum of the Common Stock Surplus and the Participating Stock Surplus, as hereinafter defined, remaining after any such dividend is deducted shall amount to ten per centum (10%) or more of the aggregate par value of all outstanding preferred stock.

The Corporation, by its Board of Directors, shall have the full right and opinion to pay all or any part of any cumulative preferred dividend on any class of preferred stock in additional stock of the same class at par, in lieu of cash dividends; provided that the proportion of such dividends paid in stock and cash, respectively, for any period shall be the same with respect to each of the several classes of the preferred stocks.

Whenever all cumulative dividends on all classes of the preferred stocks for all previous years, including any increase therein by reason of delayed payment, shall have been paid or provided for, in accordance with the provisions of this agreement of merger,

the Board of Directors may, subject to the limitations as to the surplus to be maintained for the protection of the preferred stocks, declare dividends on the Common Stock payable then or thereafter out of the Common Stock Surplus; and after such Common Stock Surplus has been paid out as dividends on Common Stock, then the Board of Directors may declare participating dividends on Common Stock and participating preferred stocks out of the Participating Stock Surplus as hereinafter provided.

92

The undistributed surplus of the Corporation shall be determined by the Board of Directors as of July 31st of each year after giving effect to all proper adjustments for the year ending on that date in the value of the assets of the Corporation and its subsidiaries, all earnings, gains and losses of both the Corporation and its subsidiaries for such year, and all reserves for imminent contingencies and hazards which the Board of Directors in its conclusive judgment may deem to be necessary in order fairly to state the surplus of the Corporation for such year, but no item of good will or going concern value shall be included in such calculation.

From the undistributed surplus for such year thus determined, an amount sufficient to pay all accrued unpaid cumulative dividends on preferred stocks, if any, shall first be deducted and set aside. From the remaining undistributed surplus, if any, there shall then be deducted an amount to be designated "Common Stock Surplus" for such year which shall be determined as follows:

The total undistributed surplus for the year ending July 31st, 1938, less any unpaid accrued dividends on preferred stocks on July 31st, 1938, shall constitute the Common Stock Surplus for the year 1938. To this Common Stock Surplus for the year 1938 there shall be added for each succeeding year an amount equal to

(1) Five Dollars per share on all Common Stock outstanding; and

(2) Four per centum per annum on the Common Stock Surplus for the preceding year, or if any dividend has been paid from such Common Stock Surplus, four per centum per annum on such surplus to the date of the dividend and four per centum per annum on the remaining balance thereafter, adjusted similarly for and as of the date of any additional dividend during the year.

After such annual additions have been made, there shall then be deducted a sum equal to all dividends paid, or provided for, on Common Stock exclusively on and after July 31st, 1938; and in the event the Corporation shall have purchased any of its outstanding Participating Four Per Cent Cumulative First Preferred Stock or its Participating Four

Percent Cumulative Second Preferred Stock during such year, any amount paid therefor in excess of its par value plus accrued cumulative dividends and its hereinafter defined pro rata share of any Participating Stock Surplus for the preceding year remaining undistributed on the date of purchase, shall be deducted therefrom, and any amount paid less than the value thus ascertained shall be added thereto.

93 The amount thus determined shall constitute and be designated as the "Common Stock Surplus" for the year for which it is determined.

Any remaining portion of such undistributed surplus for the year, after deduction of the Common Stock Surplus for such year, shall constitute and be designated as the "Participating Stock Surplus" for such year.

The Participating Stock Surplus for any year shall be available only for joint dividends on participating preferred and Common Stock, and whenever all cumulative dividends on preferred stock of all classes have been paid, or provided for, and when all the Common Stock Surplus for such year shall have been declared as dividends on the Common Stock and paid or provided for, the Board of Directors may, subject to any limitation as to the total surplus to be maintained for the protection of the preferred stocks declare participating dividends from such Participating Stock Surplus, and each share of Participating Four Per Cent Cumulative First Preferred Stock and Participating Four Per Cent Cumulative Second Preferred Stock shall, without preference or distinction between such classes for this purpose, be entitled to its pro rata share of one-half of any such participating dividend when declared, limited, however, to 1/660,000th of the total participating dividend, and each share of Common Stock shall be entitled to its proportionate part of the remainder of such participating dividend.

The action of the Board of Directors in determining the undistributed surplus, the "Common Stock Surplus" and the "Participating Stock Surplus" for any year shall be final and conclusive on all stockholders.

The amount of the authorized stock of the Corporation of any class or classes may be increased or decreased only by an amendment to this agreement adopted by the affirmative vote of the holders of a majority of the stock of the Corporation entitled to vote, provided further that the holders of a majority of the class of stock sought to be increased or decreased, and in the case of any increase in common stock, the holders of a majority of Participating Four Per Cent Cumulative First Preferred Stock and

94 the holders of a majority of the Participating Four Per Cent Cumulative Second Preferred Stock vote affirmatively for such increase or decrease.

The Participating Four Per Cent Cumulative First Preferred and the Participating Four Per Cent Cumulative Second Preferred Stock shall not be subject to redemption.

In the event of any liquidation or dissolution or winding up (either voluntary or involuntary) of the Corporation, the holders of the Participating Four Per Cent Cumulative First Preferred Stock shall be entitled to be paid in full, both the par amount of their shares and the unpaid dividends, including any increase therein by reason of delayed payment, accrued therein before any amount shall be paid to the holders of the Participating Four Per Cent Cumulative Second Preferred Stock or the Common Stock; and the holders of the Participating Four Per Cent Cumulative Second Preferred Stock shall be entitled to be paid in full, both the amount of their shares and the unpaid dividends, including any increase therein by reason of delayed payment, accrued thereon, before any amount shall be paid to the Common Stock; and when the par value and all such accrued cumulative dividends on the preferred stock of all classes shall have been paid the directors shall forthwith determine, in accordance with the provisions hereinabove set out, the Common Stock Surplus as of the date such liquidation, dissolution or winding up was determined upon, and the remaining assets to the extent of the sum of such Common Stock Surplus and the capital in respect of the Common Stock, $1.00 per share, shall be distributed pro rata among the holders of Common Stock; and when the holders of Common Stock have been paid an amount equal to $1.00 per share and such Common Stock Surplus, all remaining assets shall be distributed to holders of the participating preferred and Common Stock in the same manner and method as provided hereinabove for joint participating dividends.

The Participating Four Per Cent Cumulative First Preferred Stock, the Participating Four Per Cent Cumulative Second Preferred Stock and the Common Stock shall have equal voting rights, share for share.

95 Shares of Common Stock of the Corporation, without par value, at any time authorized to be issued, may be issued by the Corporation from time to time for such consideration as may be fixed from time to time by the Board of Directors of the Corporation and to such persons, firms and/or other corporations as the Board of Directors in its discretion may designate.

All persons who shall acquire stock in the Corporation shall acquire it subject to the provisions of this agreement.

So far as not otherwise expressly provided by the laws of the State of Delaware, the Corporation shall be entitled to treat the persons in whose names any shares are registered as the owners thereof for all purposes and shall not be bound to recognize any equitable or other claims to or interest in such shares on the part

of any other persons whether or not the Corporation shall have notice thereof.

No stockholder shall be entitled as a matter of right to subscribe for or receive additional shares of any class of stock of the Corporation whether now or hereafter authorized or any bonds, debentures, or other securities convertible into stock, but such additional shares of stock or other securities convertible into stock may be issued or disposed of by the Board of Directors to such persons and on such terms as in its discretion it shall deem advisable.

The minimum amount of capital with which the Corporation will commence business is One Thousand Dollars ($1,000.00).

FIFTH: The Corporation is to have perpetual existence.

SIXTH: The private property of the stockholders of this Corporation shall not be subject to the payment of corporate debts to any extent whatever.

SEVENTH: The number of directors of this Corporation which shall constitute the whole board shall be such as from time to time shall be fixed by, or in the manner provided in, the by-laws of the Corporation, but in no case shall the number be less than three. Directors need not be stockholders. In case of any increase in the number of directors, the additional directors may be elected by the Board of Directors to hold office until the next annual meeting of the stockholders and until their successors are elected and qualified. In case of vacancies in the Board of Directors, the Board of Directors may elect directors to fill such vacancies. Except where specifically requested by the holders of at least twenty per cent. (20%) of the outstanding stock entitled to vote at any stockholders' meeting for the election of directors, or by at least two (2) directors in the case of an election of directors by the Board of Directors, elections of directors need not be by ballot, but may be upon the oral expression of the persons participating in such meeting.

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EIGHTH: In furtherance and not in limitation of the powers conferred by statute the Board of Directors is expressly authorized:

(a) To fix, determine and vary from time to time the amount to be maintained as surplus and the amount or amounts to be set apart as working capital.

(b) To set apart out of any of the funds of the Corporation available for dividends a reserve or reserves for any proper purpose and/or to abolish any such reserve in the manner in which it was created.

(c) Without any action on the part of the stockholders to make, amend, alter, change, add to or repeal by-laws for the Corporation. The by-laws made by the directors may be

amended; altered, changed, added to or repealed by the stockholders.

(d) Without any action on the part of the stockholders to authorize and cause to be executed and delivered bonds; debentures, notes or other certificates or evidences of indebtedness of the Corporation without limit as to amount and similarly to authorize and cause to be executed and delivered mortgages and liens without limit as to amount, upon the real and personal property of the Corporation.

(e) From time to time to determine whether and to what extent, at what time and place, and under what conditions and regulations the accounts and books of the corporation, or any of them, shall be open to the inspection of any stockholder; and no stockholder shall have any right to inspect any account or book or document of the Corporation except as conferred by statute or by-laws or as authorized by a resolution of the stockholders or Board of Directors.

(f) To sell, assign, convey or otherwise dispose of a part of the property, assets and effects of this Corporation less than the whole or less than substantially the whole thereof, on such terms and conditions as shall be deemed advisable, without the assent of the stockholders in writing or otherwise; and also to sell, assign, transfer, convey and otherwise dispose of the whole or substantially the whole of the property, assets, effects, franchises and good-will of this Corporation on
97 such terms and conditions as they shall deem advisable, but only with the assent in writing or pursuant to the affirmative vote of the holders of not less than a majority of all of the shares of stock issued and outstanding and having voting power at the time such assent is required.

(g) All of the powers of this Corporation, insofar as the same lawfully may be vested by this agreement in the Board of Directors and except as otherwise provided herein, are hereby conferred upon the Board of Directors of this Corporation.

NINTH: In the absence of fraud, no contract or transaction between the Corporation and any other association or corporation shall be affected by the fact that any of the directors or officers of the Corporation are interested in or are directors or officers of such other association or corporation, and any director or officer of the Corporation individually may be a party to, or may be interested in, any such contract or transaction of the Corporation; and no such contract or transaction of the Corporation with any person or persons, firm, association or corporation, shall be affected by the fact that any director or officer of the Corporation is a party

to, or interested in, such contract or transaction, or in any way connected with such person or persons, firm, association or corporation; and each and every person who may become a director or officer of the Corporation is hereby relieved from any liability that might otherwise exist from thus contracting with the Corporation for the benefit of himself or any person, firm, association or corporation in which he may be in anywise interested.

TENTH: Except where other notice is specially required by statute, written notice of any stockholders' meeting given as provided in the by-laws shall be sufficient without publication or other form of notice, and such written notice need be given only to the holders of stock entitled to vote at such meeting. Whenever any notice whatever is required to be given under the provisions of Chapter 65 of the Revised Code of Delaware, or under the provisions of this agreement or by-laws of the Corporation, a waiver thereof in writing, signed by the person or persons entitled to said notice, whether before or after the time stated therein, shall be deemed equivalent thereto.

98 ELEVENTH: If the by-laws so provide, both stockholders and directors of this Corporation shall have power to hold their meetings either within or without the State of Delaware; and, except as otherwise provided by statute, the books of the Corporation may be kept outside of the State of Delaware at such place or places as may be from time to time designated by the Board of Directors.

TWELFTH: The Corporation may in its by-laws make any other provisions or requirements for the management or conduct of the business of the Corporation, provided the same be not inconsistent with the provisions of this agreement, or contrary to the laws of the State of Delaware or of the United States.

THIRTEENTH: The Corporation reserves the right to amend, alter, change, add to or repeal any provision contained in this agreement in the manner now or hereafter prescribed by statute, and all rights conferred on officers, directors and stockholders herein are granted subject to this reservation.

FOURTEENTH: The total amount of the stock of the Corporation to be issued for the stock of Anderson, Clayton & Co., party of the first part, is none. The shares of such party of the first part are not to be converted, but shall continue without change as shares of the Corporation.

The total amount of the stock of the Corporation to be issued for stock of Anderson, Clayton & Co., party of the second part, is none, and the shares of the party of the second part shall be deemed to be cancelled on the effective date of the merger under the terms of which the party of the first part, as owner of all outstanding shares of party of the second part, will receive all of its

assets and assume all of its liabilities in cancellation and redemption of such stock and in lieu of any shares of the Corporation.

FIFTEENTH: The by-laws of Anderson, Clayton & Co., party of the first part, shall remain and be the by-laws of the Corporation until the same shall be altered or amended according to the provisions thereof, either by the Board of Directors or by the stockholders of the Corporation. The Board of Directors of the Corporation shall have power to make and alter the by-laws of the Corporation.

99 The number of directors of the Corporation which shall constitute the whole board shall be fixed by, or in the manner provided in, the by-laws. The first Board of Directors, after the filing and recording of this agreement, shall be thirteen (13) in number, and the names and places of residence of such first directors, who shall hold office until their respective successors have been elected and qualified, are as follows:

Names	Places of Residence
Dudley B. Cannefax	Houston, Texas
Jacob C. Dellinger	Los Angeles, California
Lamar Fleming, Jr.	Houston, Texas
John H. Freeman	Houston, Texas
John P. Fuesler	Houston, Texas
Russell C. Gregg	Memphis, Tennessee
John M. Johnson	Houston, Texas
William H. Koar	New York, New York
George A. Levy	Atlanta, Georgia
Sydnor Oden	Houston, Texas
J. Ross Richardson	Houston, Texas
DeFord Sumners	Houston, Texas
Harmon Whittington	Houston, Texas

The names, title and places of residence of the first officers, after the filing and recording of this agreement, who shall hold office until their respective successors shall have been elected and qualified or otherwise, as provided in the by-laws of the Corporation shall be as follows:

Name of Officers	Title	Places of Residence
Lamar Fleming, Jr.	President	Houston, Texas
Harmon Whittington	Vice-President	Houston, Texas
Dudley B. Cannafax	Vice-President and Treasurer	Houston, Texas
William H. Koar	Vice-President	New York, New York
John P. Fuesler	Vice-President	Houston, Texas
Sydnor Oden	Vice-President	Houston, Texas
John M. Johnson	Vice-President	Houston, Texas
DeFord Sumners	Secretary	Houston, Texas
William E. Parry	Controller and Asst. Treasurer	Houston, Texas
Allen N. Hilburn	Asst. Secretary	Houston, Texas
William F. Higgins	Asst. Secretary and Asst. Treas.	New York, New York

SIXTEENTH: The Corporation shall pay all expenses of carrying this agreement into effect and of accomplishing the merger.

If at any time the Corporation shall consider or be advised that any further assignments or assurances in the law or any things are necessary or desirable to vest in the Corporation, according to the terms hereof, the title to any property, rights, privileges or franchises of Anderson, Clayton & Co., party of the second part, the proper officers and directors of Anderson, Clayton & Co., party of the second part, shall and will execute and make all such proper assignments and assurances in the law and do all things necessary or proper to vest in and confirm to the Corporation title and possession of all such property, rights, privileges and franchises and otherwise to carry out the purposes of this agreement.

SEVENTEENTH: When this agreement shall have been approved, signed, acknowledged, filed and recorded, as required by law, the separate existence of said Anderson, Clayton & Co., party of the second part, shall cease and said corporation shall be merged into Anderson, Clayton & Co., party of the first part, in accordance with this agreement, Anderson, Clayton & Co., party of the first part, possessing all the rights, privileges, powers and franchises as well of a public nature as of a private nature, and being subject to all the restrictions, disabilities and duties of said corporation so merged, and all and singular the rights, privileges, powers and franchises of said corporation, and all property, real, personal and mixed, and all debts due to said corporation on whatever account, as well for stock subscriptions as all other things in action or belonging to said corporation, shall be vested in the continuing Corporation; and all property, rights, privileges, powers and franchises, and
101 all and every other interest shall be thereafter as effectually the property of the continuing Corporation as they were of the constitutent corporation, and the title to any real estate, whether vested by deed or otherwise, vested in said corporation shall not revert or be in any manner impaired by reason of said merger; provided, that all rights of creditors and all liens upon any property of said corporation shall be preserved unimpaired, and all debts, liabilities and duties of said constitutent corporation shall thence forth attach to the continuing Corporation, and may be enforced against it to the same extent as if said debts, liabilities and duties had been incurred or contracted by it.

EIGHTEENTH: This agreement shall become effective when filed in the office of the Secretary of State of Delaware as required by the General Corporation Law of the State of Delaware, and filed in the office of the Secretary of State of California as required by the laws of the State of California.

IN WITNESS WHEREOF a majority of the directors of Anderson, Clayton & Co., a corporation of the State of Delaware, and a

majority of the directors of Anderson, Clayton & Co., a corporation of the State of California, have this 16th day of September, 1943, signed this Agreement and Act of Merger under the corporate seals of said respective corporations.

(Signed) J. M. Johnson, Jno. H. Freeman, Lamar Fleming, Jr., J. Ross Richardson, D. B. Cannafax, H. Whittington, Sydnor Oden, J. P. Fuesler, D. Sumners, being a majority of the directors of Anderson, Clayton & Co., organized under the laws of the State of Delaware.

Signed, sealed and delivered in the presence of: Pauline Kampner

ANDERSON, CLAYTON & Co., Corporate Seal, Delaware, 1929.

102 (Signed) J. C. Dellinger, Geo. Cleveland, R. L. Lesnett, D. B. Cannafax, Lamar Fleming, Jr., D. Sumners, being a majority of the directors of Anderson, Clayton & Co., organized under the laws of the State of California.

Signed, sealed and delivered in the presence of: G. D. Hindman and Pauline Kampner.

ANDERSON, CLAYTON & Co. Corporate Seal, California, 1935.

IN FURTHER WITNESS WHEREOF, this Agreement of Merger, having been approved by resolution of the Board of Directors of Anderson, Clayton & Co., party of the first part, a corporation organized and existing under the laws of the State of Delaware, the said corporation has caused this agreement to be signed by its President and its Secretary under its corporate seal.

ANDERSON, CLAYTON & Co.

By LAMAR FLEMING, JR.,

President.

By D. SUMNERS,

Secretary.

ANDERSON, CLAYTON & Co. Corporate Seal, Delaware, 1929.

IN FURTHER WITNESS WHEREOF, this Agreement of Merger, having been approved by resolution of the Board of Directors of Anderson, Clayton & Co., party of the second part, a corporation organized and existing under the laws of the State of California, the said corporation has caused this agreement to be signed by its President and its Secretary under its corporate seal.

ANDERSON, CLAYTON & Co.

By J. C. DELLINGER,

President.

By L. J. BRUNGS,

Secretary.

ANDERSON, CLAYTON & Co. Corporate Seal, California, 1935.

103 I. D. SUMNERS, Secretary of ANDERSON, CLAYTON & Co., a corporation of the State of Delaware, hereby certify, as such secretary and under the seal of that corporation, that the Agreement of Merger to which this certificate is attached, after having been first duly signed by a majority of the directors of said corporation, as required by the provisions of the General Corporation Law of Delaware, and approved by resolution of the board of directors and signed by the president and the secretary of ANDERSON, CLAYTON & Co., a corporation of the State of California, was duly submitted to the stockholders of said ANDERSON, CLAYTON & Co. (Delaware Corporation), at a special meeting of said stockholders called separately for the purpose of considering and taking action upon said Agreement of Merger and held after due notice, on the 18th day of September, 1943, that more than two-thirds of the total number of shares of the outstanding capital stock of said ANDERSON, CLAYTON & Co., (Delaware Corporation), was represented at said meeting, and that at said meeting the votes of the stockholders of said ANDERSON, CLAYTON & Co., (Delaware Corporation), representing more than two-thirds of the total number of shares of its outstanding capital stock were cast, by ballot, in favor of the adoption of said Agreement of Merger, which Agreement of Merger was thereby at said meeting duly adopted as the act of the stockholders of said ANDERSON, CLAYTON & Co., (Delaware Corporation).

WITNESS my hand and the seal of said ANDERSON, CLAYTON & Co., (Delaware Corporation), on this 20th day of September, 1943.

D. SUMNERS,
Secretary.

ANDERSON, CLAYTON & Co. Corporate Seal, Delaware, 1929.

104 CERTIFICATE OF PRESIDENT AND SECRETARY OF ANDERSON, CLAYTON & CO.

A Corporation of the State of California,
Showing Approval of Agreement of Merger

We, J. C. DELLINGER, president, and L. J. BRUNGS, secretary, of ANDERSON, CLAYTON & Co., a corporation duly organized and existing under the laws of the State of California, do hereby certify:

1. That a meeting of the Board of Directors of said corporation was held at Los Angeles, California, on the 21st day of August, 1943, for the purpose of considering the advisability of approving a proposed merger of the said corporation into ANDERSON, CLAYTON & Co., a corporation of the State of Delaware.

2. That at said meeting of the Board of Directors, the following resolution, approving the said merger, was adopted:

WHEREAS, a plan for the complete liquidation and merger of the corporation into Anderson, Clayton & Co., (Delaware) has been adopted by such company and this corporation, and provides for the transfer of all the property of this corporation, subject to its liabilities, to such company in cancelation and redemption of all its capital stock, and in lieu of shares of stock of the continuing corporation.

RESOLVED that in the judgment of this Board of Directors it is advisable and for the best interests of this corporation that it be merged into ANDERSON, CLAYTON & CO., a corporation organized and existing under the laws of the State of Delaware, and

FURTHER RESOLVED that the draft of the Agreement of Merger providing for the merger of this corporation into said ANDERSON, CLAYTON & CO. be and it hereby is approved and the president (or vice-president) and the secretary (or assistant secretary) be and they hereby are authorized and directed to sign and acknowledge the Agreement of Merger submitted to this meeting on behalf of this corporation.

3. That three directors voted in favor of said resolution and no directors voted against said resolution.

4. That on the 24th day of August, 1943, the secretary
105 of this corporation mailed to each holder of record of every class of stock of this corporation (whether or not their voting rights were restricted or denied by the articles of incorporation) notice of a special meeting of the stockholders of the corporation to consider the advisability of approving the proposed merger of this corporation into ANDERSON, CLAYTON & CO., a corporation organized and existing under the laws of the State of Delaware; to which notice was attached a statement of the terms and conditions of the proposed Agreement of Merger.

5. That the special meeting of the stockholders of this corporation to consider the advisability of approving the proposed Agreement of Merger, merging this corporation into ANDERSON, CLAYTON & CO., a corporation of the State of Delaware, was held at Los Angeles, California, on the 18th day of September, 1943, and that the said Agreement of Merger was approved by the affirmative vote of the holders of One Thousand (1,000) Shares of Common Stock, being the holders of more than two-thirds of the issued and outstanding shares of each class, whether or not their right to vote be restricted or denied by the articles of incorporation fo the corporation.

6. At the time of the holding of the special meeting of stock-

holders called for the purpose of considering the advisability of approving the proposed merger, there were issued and outstanding One Thousand (1,000) Shares of Common Stock.

IN WITNESS WHEREOF, we have hereunto set our hands and affixed hereto the corporate seal this 18th day of September, 1943.

J. C. DELLINGER,
President of ANDERSON, CLAYTON & Co.,
L. J. BRUNGS,
Secretary of ANDERSON, CLAYTON & Co.

Corporate Seal.

106 STATE OF CALIFORNIA,
County of Los Angeles, ss:

On this 18th day of September, 1943, before me personally came J. C. DELLINGER and L. J. BRUNGS, to me known, who, being by me duly and severally sworn, each for himself, deposes and says: That he, the said J. C. DELLINGER, is president and that he, the said L. J. BRUNGS, is secretary of ANDERSON, CLAYTON & Co., a corporation organized and existing under the laws of the State of California, and that the facts set forth in the foregoing certificate are, in all respects, true and correct.

(S.) J. C. DELLINGER,
(S.) L. J. BRUNGS.

Subscribed and sworn to before me this 18th day of September, 1943.

———————,
Notary Public.

My Commission Expires October 26, 1945.

107 THE ABOVE AGREEMENT OF MERGER, having been executed by a majority of the Board of Directors of ANDERSON, CLAYTON & Co., a corporation organized and existing under and by virtue of the laws of the State of Delaware (and having been executed by the other corporate party thereto in the manner prescribed by the laws of the state under which it was organized) and having been adopted separatedly by the stockholders of each corporate party thereto, as to said ANDERSON, CLAYTON & Co. (Delaware Corporation), in accordance with the provisions of Section 59 of the General Corporation Law of the State of Delaware, and as to said ANDERSON, CLAYTON & Co. (California Corporation) in accordance with the provisions of the Civil Code of California in that behalf, and that fact having been certified by the secretary of each corporate party thereto, the president and secretary of said ANDERSON, CLAYTON & Co. (Delaware Corporation) do now hereby execute the said Agreement of Merger under its corporate seal, by

authority of the directors and stockholders thereof, as the act, deed and agreement of said corporation, on this 20th day of September, 1943.

ANDERSON, CLAYTON & CO.,
LAMAR FLEMING, JR., *President.*
D. SUMNERS, *Secretary.*

ANDERSON, CLAYTON & CO.
Corporate Seal
Delaware
1929

Attest:
D. SUMNERS,
Secretary.

108 STATE OF TEXAS,
County of Harris, ss:

BE IT REMEMBERED, that on this 20th day of September, A. D. 1943, personally came before me R. M. Bleike, a Notary Public, in and for the county and state aforesaid, LAMAR FLEMING, JR., president of ANDERSON, CLAYTON & CO., a corporation organized and existing under and by virtue of the laws of the State of Delaware, and one of the corporations described in and which executed the foregoing Agreement of Merger, known to me personally to be such, and he the said LAMAR FLEMING, JR., as such president duly executed said Agreement of Merger before me and acknowledged said Agreement of Merger to be the act, deed and agreement of said ANDERSON, CLAYTON & CO., that the signatures of the said president and the secretary of said corporation to said foregoing Agreement of Merger are in the handwriting of said president and secretary of said ANDERSON, CLAYTON & CO., and that the seal affixed to said Agreement of Merger is the common corporate seal of said corporation.

IN WITNESS WHEREOF, I have hereunto set my hand and seal of office the day and year aforesaid.

R. M. BLEIKE,
Notary Public, in and for Harris County, Texas.

My Commission Expires June 1, 1945.

NOTARY PUBLIC,
County of Harris, Texas.

Here follows 1 photolithograph, side folio 109

704

State of Delaware

Office of Secretary of State

I, William J. Storey, Secretary of State of the State of Delaware, do hereby certify that the above and foregoing is a true and correct copy of Certificate of Agreement of Merger between "ANDERSON, CLAYTON & CO." a corporation organized and existing under the laws of the State of California and "ANDERSON, CLAYTON & CO.", a corporation organized and existing under the laws of the State of Delaware, under the name of "ANDERSON, CLAYTON & CO." as received and filed in this office the twenty-seventh day of September, A. D. 1943, at 9 o'clock A.M.

And I do hereby further certify that the aforesaid Corporation shall be governed by the Laws of the State of Delaware.

In Testimony Whereof, I have hereunto set my hand and official seal at Dover this twenty-seventh day of September in the year of our Lord one thousand nine hundred and forty-three.

William J. Storey
Secretary of State

110 PLAINTIFF'S EXHIBIT NO. 6

MINUTES OF MEETING OF DIRECTORS
OF ANDERSON, CLAYTON & CO.
November 30, 1943

A special meeting of the Board of Directors of Anderson, Clayton & Co. was held in the office of the company, Cotton Exchange Building, Houston, Texas, on November 30, 1943, at 10:00 o'clock a. m., pursuant to notice thereof duly and regularly given to all directors.

The following directors were present:

D. B. Cannafax	Sydnor Oden
Lamar Fleming, Jr.	J. Ross Richardson
Jno. H. Freeman	D. Sumners
J. P. Fuesler	Harmon Whittington
J. M. Johnson	

Lamar Fleming, Jr., President of the corporation, acted as chairman of the meeting, and D. Sumners, Secretary of the corporation, acted as secretary of the meeting.

The President stated that one of the purposes of the meeting was to consider the matter of declaring a dividend upon the common stock of the corporation, and that before the matter was acted upon he desired to bring certain facts to the attention of the directors, believing that such facts should be considered in connection with the dividend matter. He then presented the following statement:

"One of the purposes of this meeting is to decide what, if any, dividends to declare on the common stock. We all will agree this question must be approached with even greater delicacy, now that our corporation is the operating and borrowing entity, than was the case when the joint stock association and not the corporation was the borrower from banks. At least theoretically, the common dividends passed, except only for a small fraction, into the hands of persons having individual liability to creditors, as shareholders of the joint stock association; whereas, since the corporation has been substituted as the borrower, the total amount of the dividends is now subtracted from the aggregate assets available to creditors.

"When we discussed our plans for the merger with our bankers and the withdrawal of the personal liabilities which would result from the substitution of an incorporate borrower, they gave their approval to the entire reorganization and consented to extend to the corporation the same credit accommodations which they had been making available to the joint stock association. This cooperative attitude, however, was premised upon

the assumption that the change in corporate status would not affect the continuity of our policies, particularly with regard to the protection of those from whom we borrow. At several banks, it was mentioned specifically that their attitude toward us presupposed a reasonable and conservative dividend policy.

111 "I think the facts before us are as follows:

"(1) The combined earnings for the year ended July 31, 1943, of the corporation and the two subsidiaries, i. e., the joint stock association and the California corporation, which were merged into it immediately after the close of the year, amounted to about $3,900,000 after payment of approximately $1,724,000 of income taxes. Of this amount, about $1,700,000 was derived from cotton merchandising and about $2,200,000 from dividends and interest received principally from subsidiaries of the joint stock association.

"(2) The net current position, which the Banks regard as of first importance in considering credit accommodations to us, was increased $1,419,000 after payment of about $1,307,000 dividends on the preferred.

"(3) The prospects for operating results this season are unfavorable.

"We do not dare take a long basis position in cotton merchandising, hedged by sales of distant futures deliveries, which are at a discount, since that would add the discounts to the other carrying costs of interest, insurance, and storage. We have found it impossible to take the reverse position, short of the basis at premiums which we would be willing to accept, due to a general policy on the part of the mills to restrict their forward commitments. So we are just trying to do a turnover business, which is difficult in the face of discounts.

"The oil mill subsidiaries are in a less favorable situation than last year, due to the fact that the 1943 Commodity Credit Corporation Program has narrowed the margin between seed prices and products prices, notwithstanding the gradual increase in cost of processing. In the case of our mills, the unit cost of processing is further enhanced by the reduced crops in West Texas, West Oklahoma, and California, and Arizona.

"The prospects for our compress companies also are unfavorable. Many of their operations are being done at a loss, due principally to ceilings on charges and the limited availability of labor, in order to keep our and other customers' cotton business operating.

"(4) The market risks of our cotton business are greatly augmented by the breakdown of the hedging system which has resulted from present abnormal conditions. Experience by now has proved that the effectiveness of a futures hedge and a regime of Government floors and ceilings simply do not get along together. We thus have been compelled reluctantly to forego the use of hedges on a considerable portion of our stocks, particularly those qualities whose values are related more to loan rates than futures prices. Of course, we have explained this development to the Banks, who obviously cannot regard loans to us on unhedged cotton to be as well secured as the old-time loans on hedged cotton." From our point of
112 view, we must recognize the greater hazard entailed in unhedged business and the possibility that we might suffer a serious depreciation in inventory values, particularly in the event of a sudden termination of the War.

"(5) We are financing our South American subsidiaries in carrying very large stocks of cotton, of a value in excess of half our net current assets. These stocks are unhedgeable. The bulk of them is in Brazil, and eventual liquidation into dollars depends upon permits of the Brazilian Exchange Control and upon the possibility of selling the cotton in a free currency, as contrasted to blocked sterling or other blocked currency. Our American banks do not regard cotton in Brazil as first-class collateral, for the foregoing and other reasons.

"We discussed this heavy engagement in South American cotton with our banks last summer. Generally they considered the operation sound, although we did meet with some criticism of it; but it was contemplated by them and ourselves at the time that there would be a gradual liquidation, which would reduce the commitment to much smaller figures before the commencement of new crop movement next April. Thus far, we have been disappointed in this liquidation and we must recognize a serious probability that we will go into the South American new crop with very large stocks from prior crops. This would necessitate our arranging much larger banking facilities before next spring for South American cotton, which the banks do not regard as first-class security, or else would compel our South American subsidiaries to curtail their operations of merchandising, ginning, and crushing. The latter alternative must be avoided, if possible, not only for profit-and-loss considerations, but also because it would be most serious to our good will in those countries to curtail our services at a time when they are most needed.

"(6) Generally we face the uncertainties inherent in the closing chapters of the greatest war in history, and cannot

presume to foresee the needs for liquid capital with which we may be confronted.

"I think we all would like to declare a common dividend sufficient to bring to a current basis the payments of $5.00 per share per year which are contemplated in the 1938 amendment to the charter, that is to pay now $10.00 per common share. Those of us who have discussed the matter were at first in some doubt whether the payment of such a dividend would be fully warranted under the circumstances which I have attempted to describe and in our first year of borrowing as a corporation. Therefore, Mr. Cannafax, Mr. Koa, and I recently made the occasion to go into this matter and our whole situation with our principal bankers; and I am glad to say that it is with their approval that we recommend a $10.00 dividend on the common stock."

Following some discussion, upon motion by Director Fuesler, seconded by Director Freeman, the following resolution was unanimously adopted, viz:

113 RESOLVED, that a dividend of Ten Dollars ($10.00) per share on the common stock of the corporation, payable immediately to stockholders of record at the close of business on November 29, 1943, be, and the same is, hereby declared.

The President stated that another purpose of the meeting was to consider and determine the undistributed surplus of the corporation as of July 31, 1943, and the division of such surplus into common stock surplus and participating stock surplus, all as provided to be done by the charter of the corporation. The Treasurer then presented a balance sheet and statement which had been made up under his direction, and explained to the directors the adjustments for the fiscal year that had been made in values of assets of the corporation and its subsidiaries, the reasons for the various reserves that had been set up in the balance sheet, and generally the matters that had been taken into account fairly to state the surplus of the corporation for the fiscal year closing July 31, 1943. The statement attached to the balance sheet allocated the surplus shown to the common stock surplus and the participating stock surplus, as provided by the charter of the corporation. The balance sheet and statement submitted were as follows:

114

Anderson, Clayton & Co.
(A Delaware Corporation)

Balance Sheet—July 31, 1943

(Giving effect to merger into that corporation of subsidiaries, Anderson, Clayton & Co., a Texas joint stock association, and Anderson, Clayton & Co., a California Corporation.)

Assets

Current Assets:		
Cash in banks		$ 4,349,682.72
U. S. Treasury bonds at cost:		
Pledged to banks	$ 1,050,000.00	
Deposited as margins on cotton futures	718,775.00	1,768,775.00
Certificates of interest in cotton producers' notes, pledged to banks		8,351,800.00
Cotton documents in process of collection		4,847,965.00
Accounts receivable		2,028,019.51
Advances to domestic subsidiaries		7,724,533.31
Advances to foreign subsidiaries		18,751,836.47
Deposits with brokers, less market differences		47,469.99
Market differences in outstanding contracts, net		1,397,800.14
Inventories:		
Cotton, at market	38,141,344.96	
Material and supplies, at cost	163,317.58	38,304,662.54
		$ 87,572,544.68
Other Assets:		
Other receivables, including employees	$ 439,872.67	
Prepaid expenses	94,250.47	534,123.14
Investments:		
Stocks of subsidiaries at book values of respective companies	35,347,387.06	
Non-current advances to domestic subsidiaries	975,000.00	
Other investments	1,241,909.61	37,564,296.67
Fixed Assets, less reserves for depreciation and valuation		278,241.45
		$125,949,205.94

115 Liabilities

Current Liabilities:		
Notes payable, secured	$ 41,515,198 44	
Notes payable, unsecured	2,859,990 21	
Accounts payable and accrued expenses	8,891,748 82	
Dividends paid August 3, 1943	1,307,408 00	
Reserve for Federal income taxes	1,574,534 87	$ 56,148,880 34
Reserves:		
For managers' commissions, contingently payable subsequent to July 31, 1944	945,662 95	
For valuation of investments in subsidiaries	5,000,000 00	5,945,662 95
Long Term Indebtedness:		
4% Debentures, maturing 1951	3,241,400 00	
4% Debentures, maturing 1953	2,693,500 00	
Subordinated to bank indebtedness prior to redemption or maturity:		
4% Debentures, maturing 1979-88	5,481,500 00	
4¼% Debentures, maturing 1989-98	4,939,300 00	16,356,700 00
Capital Stock and Surplus:		
Participating 4% Cumulative preferred Stock, par value $100.00 per share:		
First preferred, 272,411 shares	27,241,100 00	
Second preferred, 54,411 shares	5,444,100 00	
	32,685,200 00	
Common stock, no par value, 84,083 shares	84,083 00	
Surplus, per annexed statement	14,728,679 65	47,497,962 65
		$125,949,205 94

116 Statement of Allocation of Surplus as at July 31, 1943

Surplus per balance sheet			$14,728,679.65
Common stock surplus:			
Balance at July 31, 1942		$5,079,070.03	
Provision for cumulative $5.00 per share and 4% on balance	$623,352.80		
Less adjustment account 665 shares purchased	54,796.84	568,555.96	5,647,625.99
Participating surplus			$9,081,053.66
326,852/660,000 applicable to preferred stocks			$ 4,497,212.96
333,148/660,000 applicable to common stock			4,583,840.70
			$9,081,053.66

Valuation of Stocks

Preferred—326,852 shares outstanding, par value	$32,685,200.00
Participating surplus	4,497,212.96
Total value ($143.76 per share)	$37,182,412.96
Common—84,083 shares outstanding, paid in value	$ 84,083.00
Common stock surplus	5,647,625.99
Participating surplus	4,583,840.70
Total value ($122.68 per share)	$10,315,549.69

On motion by Director Whittington, seconded by Director Johnson, the following resolution was adopted:

RESOLVED, that the balance sheet and statement submitted to this meeting by the Treasurer of the Company be, and the same are hereby approved and adopted as fairly stating the position of the corporation as of July 31, 1943; that the allocation to common stock surplus and participating stock surplus of the total surplus, as shown therein, be, and the same is hereby approved and adopted, and that each holder of common stock be advised by the Secretary of the per share value thereof, as shown by such balance sheet and statement.

The President stated that another purpose of the meeting was to consider authorization of sale of certain of the common stock of the corporation now in the treasury thereof, to certain active officers of the corporation. Following some discussion of the
117 matter, the following resolution was offered, and upon motion duly seconded, was adopted:

RESOLVED, that from the common stock of this corporation now in the treasury, there be sold the following numbers of shares to the following persons, respectively, viz:

2,000 shares to H. Whittington
1,500 shares to W. H. Koar
1,250 shares to Sydnor Oden

1,250 shares to J. M. Johnson
500 shares to W. E. Parry

being an aggregate of 6,500 shares to be sold, such stock not to participate in the dividend this day declared, and to be sold at the price of One Hundred Twelve and 68/100 Dollars ($112.68) per share, being the value per share determined by the balance sheet heretofore adopted at this meeting, less the $10.00 per share dividend declared at this meeting; and

BE IT FURTHER RESOLVED, that in payment for said stock, the corporation accept the notes of the several persons to whom the stock is sold for the full amount of the purchase price thereof, such notes, except as to amounts and numbers of shares, to be in substantially the following form:

$———— Houston, Texas, ————, 19——.

ON DEMAND, I promise to pay to the order of ANDERSON, CLAYTON & Co., (A Delaware Corporation) at its offices in Houston, Texas, the sum of ———— DOLLARS, or in lieu thereof at my option to deliver to them in full satisfaction of this obligation, both principal and unpaid interest, ——— shares of the common stock of Anderson, Clayton & Co., a Delaware corporation. Partial payments hereon may be made at my option and in the event this obligation has been reduced by such payment prior to the maturity hereof, then the remainder of such note may be satisfied by delivery of the proportion of said stock as the amount of principal remaining due is to the said sum of $———.

This note shall bear interest from the date hereof at the rate of four per cent, and such interest shall be payable at the maturity hereof, except that upon the receipt of any dividend upon said common stock, interest accrued to the date such dividend is declared shall become due and payable.

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and one such note to be executed by each of said purchasers severally in favor of the corporation, for the purchase price as set out in this resolution, of the number of shares purchased by him individually, as authorized by this resolution.

118 None of the directors of the corporation who were named in the above resolution voted upon the matter of the adoption thereof.

There being no further business to come before the meeting, the same was, upon motion, duly adjourned.

(S.) D. SUMNERS,
Secretary.

(S.) LAMAR FLEMING, JR.,
President.

Treasury Stock

1932					1932			
		145 shares purchased from Estate of Ed Keene		14500	Dec 31	Sale of Treasury Stock	X45	14500
June 12		7600 Sh Common purchased from Estate of L.L. Blanton	295	2694469	July 5	(WHK - 1000 - V.11.597) Sold 1500 Shs of Treasury Stock	313	155984
				2694469		To Balance		113485
								2694469
July 1		Balance		N3485	May 1935	Sold 100 Sh Treasury Stock (CNBC)	X80	114006
Sept 21		Gain on sale Treasury Stock	21	80521				
				114006				114006
Dec 5		Purchase of 18574 Sh Common Stock	79	94337346	Dec 1935	(WLA) Sold 3035 Shs Comm	X9	15414765
					July 31	To Balance		78922581
				94337346				94337346
1940		Balance		78922581	Dec 27	(WHK) Sold 1000 Shs @ 33½	X6	3362000
Dec 10		Purchase 18 Shs @ 32½	41	58086	1941 July 31	To Balance		79905267
1941								
July 31		To balance at average value 1275 Shs common Stock	142	4286750				
				83267417				33267217
1941		Balance		79905267	1943 Jan 25	Balance of Cost 1000 Shs sold	80	1717000
Nov 30 1942		2776 Sh common Repurchased	40	2776000	July 31	To Balance		8811029
Dec 28		Cost of original Stock Sold 2776 Shs	80	7426312				
				87855129				87855129
1943		Balance		85840120	1943 July 1	Trf to Machine Ledger		91273217
Jan 7		Purch 65 Sh Common	55	526500				
14		300	6	2431700				
June 28		300	97	2474854				
				91273217				91273217

PLAINTIFF'S EXHIBIT NO. 7

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Surplus

1941						1941					
July 31	To Balance			48 63 22 8	10	July 31	By stock investment in stocks at respective book values as of			26 24 73 6	
							"			22 38 47	56
				48 63 22 8	10					48 63 22 8	10
Dec 30	Adjust Stock appreciation 7/1	4		1 23 75 1	97		Balance			48 63 22 8	10
" 30	Cost over stated value of 22 76 shares Common Stk	4		9 4 2		Dec 31	From Common Stock Surplus	53		44 59 26	6
							Reserves	53		17 70 57	
30	Dft to Common Stk Surplus	4		28 94 6	10	1942					
	Preferred Stk Surplus	4		17 70 57		July 18	Canal No 11/30		80	74 24	
1942						May 31	Overaccrue Fed Inc Tax			3 45	57
July 18	Loss on Sale of Treasury Stk			67		July	appreciation of stock held		131	53 28	51
July 13	adjust Reserve for Exam Cost Treasury Stock Common			57 07	12				132	27 4 86	73
13	Add Cap Stock Sale	10		2 50		1940	Dft from P & L	4	133	17 06	48
31	To Balance			82 22 49	32						
				184 97	54					184 97	54
Dec 16	Increase Fed Inc Tax Accrue	41		5 3			Balance			82 22 49	32
1942	Exam cost purchase of 50 Com Stk	50		5		Dec 1943	Reduce Cap Stk to Par	45		44 37	50
	300			24		July 31	Appreciation in stocks held	126		77 41 16	08
July 18	300	98		24 44 8							
July 31	Add. income tax 1940 adjt	123		90	09	Aug 1	Dft to Machine Ledger			17 16 40	41 04
"	Dividend provided for	125		13 07 40	80						
"	Dft P & L	126		13 64 34	38						
"	Appreciation of J.S.A.	127		20 97 76	95						
"	Cost amortization of 51,815 shs. J.S.A.			9 39 42	58						
				33 47 20	31					33 47 20	31

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PLAINTIFF'S EXHIBIT NO. 8

Surplus

1937						1937			
July 30	Dividends Paid	52		1043218			Balance Forwarded		14316237
31	1st Pfd Div. 8/1/36 7/31/37	95		54803656	July 31		1st Pfd Dividends for 7/31/36	95	15412834646
	2nd	95		46251725			Increased Value of Investments	97	2107543600
	Prov for Contingent Div on 1st Pfd	95		30578500			From P & L	98	14419025
	2nd	95		8807900					
	Accrued Tax Adj Dec-Jan 38-39 310.03	95		3705477					
	To Balance			123652273					
				367558449					367558449
May 31 1938	Exc div 5/31/38 on 167 shares 1st pfd acquired	80		23867	Aug 1 1937		Balance		123652273
July 31	Prov for accrued div on 1st Pfd	110		4754815	July 31 1938		First Pfd Div proposed for 7/31/37	95	15480356
31	" Contingent div on 1st Pfd	110		3400000			Over accrued income tax 3/31/37		13723
31	From P & L	127		2856453			Estimated overaccrual Excess tax	127	1077676
	To Balance			547407366			Transfer from Reserve for Valuation of Investments	170	2000000
				636280192					636280192
Dec 31 1938	Adj Value investments as 7/31/38	64		60575203	Aug 1		Balance		547407366
	Value applicable to preferred stock	65		47076625	July 31		Prov for Cont Div on 1st Pfd	110	18534370
July 31 1939	Cost of investments at book value			64070600	Jan 31 1939		Cum Div	110	4358 66
	Trf to Surplus Allocated to Common	64		32163467			Excess of Book value over Cost of purchase of 10 shs for retirement	64	4
				87330705			From P & L		46446
									87330705
Dec 31 1938	Excess of Cost of Common Stock	5		5670	July 1		Appreciation in investments		
July 31	Trf to Profit & Loss	146		4641222			for year ended 7/31/38	146	2058863
31	Trf to Surplus Allocated to Preferred Stocks	146		3097600			Loss on Sale 3-35 Lone Common Store trf'd to Surplus	146	
31	Trf to Surplus Allocated to Common Stock	146		46197333			allocated to Common Stock		56208570
				54940263					54940263

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Surplus - Allocated to Common Stock

1940									1939										
July		Cat over for yr 15,539 Dr																	
		Treasury Stock					779	596	July	31									
	31	Loss on 3035 Sh Common																	
		sold out of treasury Stock					56	20											
		Do Balance					2841	42	5	02									
							3678	32	0	02									
Dec	40																		
July	41				47			562	86				Balance						
	28				95	X		43	90		1941	28	To 1000 Sh T.S. Comm				95		826	20	00
		Dividend Accrued 7% Pfd			95			70	35	91							95		17	70	00
July	31	re: exchange dif for Comm			111	X		41	59	99	July	3	adj entry				161	X		43	90
		Do Balance					2836	25	75												
							2198	25	192										1891	58	92
																			1835	85	75
Nov		15% Stock dividend 11/12/41			39		1271	220	00		1941		Balance								
Dec	31	Cfr to Surplus			58		44	326	76		Nov	3	Cfr from Surplus				45		2894	661	01
							3720	486	76										730	486	76

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PLAINTIFF'S EXHIBIT NO. 10

ACCOUNT No 1805

PAGE No 1

TREASURY STOCK - COMMON

ORIGINATOR	DATE	VOU NO	EXPLANATION	VAL DATE	DEBIT	CREDIT	BALANCE
			18,723				
OD	AUG 31 43	21-H	18,618 SHARES		912,732.17		912,732.17
2,732.17	DEC 31 43	115C	6500 SHARES SOLD	12-18-43		6,000.00	
			EXCESS OF COST OVER STATED VALUE OF 6500 SHARES SOLD	12-18-43		309,526.16	596,706.01
596,706.01	JAN 31	152D	ADJ. JE. 115-C			14,108.84	582,597.17
						BALANCE TRANSFERRED TO NEW LEDGER	

LOOSE LEAF SERVICE, BOSTON

ADCO 18

PLAINTIFF'S EXHIBIT NO. 11

ACCOUNT NO 1307

PAGE NO 1

EARNED SURPLUS

OLD BALANCE	DATE	VOU NO	EXPLANATION	VAL DATE	DEBIT	CREDIT	BALANCE
.00	AUG 21 43	9-K	4% ON 1ST & 2ND PARTICIPATING PREFERRED STOCK	8/2 2.0	1,307,408.00		1,307,408.00
07,408.0	AUG 31 43	21-H	TFR DEL.CORPN. TO HOUSTON BOOKS		17,464,041.04		18,771,449.04
18,771,449.04	NOV 30 43	101A	DIVIDEND OF $10.00 PER SHARE ON 84,083 SHS.COM.	11-30-43	840,830.00		
			SURPLUS OF SUBSIDIARY (LA). ACQUIRED IN MERGER	10-1-43		660,271.51	18,952,007.53
18,952,007.53	DEC 31 43	114K	ADJ. RES. FOR MGRS. COMM.			50.01	18,951,957.52
18,951,957.52	[illegible]	152A	X ON JE 9-K			7,408.00	17,644,549.52
17,644,549.52	FEB 29	162D	TFRD FROM A/C 1308			31,154,295.75	13,709,746.23
13,709,746.23	MAR [illegible] 44	192D	ADJ.RES.FOR VAL.COTTON EXCH. MEMBERSHIPS			2,941.86	
			ADJ. RES. FOR VAL. OF INVESTMENTS IN LIQUIDATION			415.00	
			ADJ. RES. FOR VAL.OTHER STOCKS			726.00	13,713,829.09
13,713,829.09	[illegible] 44	201L	CANCEL P.T. OF JE 165-K OF 7-31-41, LOSS ON CAPITAL STOCK OF TERMINAL COMP.&WHSE.CO. ADDED TO COST OF STOCK OF TERMINAL WHSE.CO.		96,073.35		13,617,755.74
13,617,755.74	[illegible] 44	222J	ADD'L INC. TAX YR. 7/31/42		5,730.97		13,612,024.77
13,612,024.77	[illegible] 44	253H	REFUND OF ASSESSMENT INC. TAX 7/31/38			52,444.15	
			1941/42 CR. [illegible],922.80 AT 10.00				
			BRAZIL,TAX [illegible] INTEREST		[illegible]		
			REFUND 1937/42 INDIAN TAX			[illegible].00	
			ADJ. JE 1224 DEAC. [illegible]		[illegible].57		13,[illegible],805.84
13,539,805.84	[illegible] 44	253J	C.E.& A. PRIOR YEAR - [illegible]				
			CITY C/O CO. IN LIQUIDATION			[illegible]	13,539,925.53
13,539,925.53	JUN 30 45	281B	ADDNL.STATE INC TAX YEAR ENDED 7-31-40 SEE.JE 264D		6,593.48		
			ADDNL. STATE INC TAX YEAR ENDED 7-31-41 SEE JE 264D		3,198.35		
			ADDNL. STATE INC TAX YEAR ENDED 7-31-42 SEE JE 264-D		673.04		13,529,460.66
13,529,460.66	JUL 31 44	291B	ADDNL. INCOME & PROFITS TAXES JOINT STOCK ASSN. YEAR ENDED 7-31-40		132,405.47		13,397,055.19
13,397,055.19	JUL 31 44	303F	4% 1ST & 2ND PARTICIPATING PREFERRED STOCK	6/30/40	1,307,408.00		12,089,647.19
12089,647.19	JUL 31 44	314E	REFUND F.I.TAX CALIF.CORPN.F.Y.			59.42	12,089,716.61
89,716.51	JUL 31 44	314M	LONG BEACH MACHINE WORKS PERIOD ENDED 7/31/42.		1,916.79		
			LONG BEACH MACHINE WORKS PERIOD ENDED 7/31/43.			94,13.47	
			LONG BEACH MACHINE WORKS PERIOD ENDED 7/31/44.			1,379.79	12,253,343.04

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[redacted]

ACCOUNT NO 1307

PAGE NO 2

EARNED SURPLUS

OLD BALANCE	DATE	VOU NO	EXPLANATION	VAL DATE	DEBIT	CREDIT	BALANCE
[illegible]3,343.04	Jl 31 44	3140	ADJUSTING RES. FOR VAL. FIXED ASSETS.			2,402.24	12,955,805.28
85,805.28	Jl 31 44	314T	ADJ. RES. VAL. EMPLYS NOTES		36,326.80		
			ADJ. RES. VAL. FOREIGN ACCTS.		9,354.65		12,910,123.83
10,123.83	Jl 31 44	314U	PROVISIONAL ADD'L. INCOME TAX 7/31/42		51,832.22		
			PROVISIONAL ADD'L. INCOME TAX 7/31/43		3,120.04		
			INCOME TAX LA CORP'N. 9/30/43		455.92		
			ADJ. RES. FOR MGRS. COMMISSIONS		117,315.32		
			ADJ. PROFITS LRM WKS 7/31/43		301,855.17		
			ADJ. PROFITS LRM WKS. 7/31/44		261,327.75		
			RESTORE PART RES. FOR VAL. STKS. OF SUBS. [illegible]			910,425.96	
			RESERVE FOR EMPLOYEES RETIREMENT		2,001,347.00		
11,083,296.37	Jl 31 44	314U	APPRECIATION OF STOCKS IN SUBSIDIARIES			3,260,685.37	14,343,981.74
14,343,981.74	Jl 31 44	314U	ADJ. RES. FOR OTHER STOCKS			525.11	
			ADJ. RES. FOR EMPLYS NOTES			15,750.00	14,360,256.85
14,360,256.85	Jl 31 44	314V	EARNINGS 7/31/44			2,667,915.77	17,028,172.62

BALANCE TRANSFERRED TO NEW LEDGER

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PLAINTIFF'S EXHIBIT NO. 12

ACCOUNT NO 1506

PAGE NO 3

CAPITAL SURPLUS

OLD BALANCE	DATE	NO.	EXPLANATION	VAL. DATE	DEBIT	CREDIT	BALANCE
.00	DEC 31 43	115C	ACCT. 6500 SHS.COMMON TREASURY STOCK SOLD	12-18-43		725,920.00	725,920.00
25,920.00	MAR 31 44	192D	RES FOR VAL.EMPLOYEES NOTES		720,420.00		5,500.00
5,500.00	JUL 31 44	314U	TO RES. FOR EMPLYS. NOTES		5,500.00		.00

127 SUPREME COURT OF THE UNITED STATES—October Term, 1954

No. 504

UNITED STATES, PETITIONER

vs.

ANDERSON, CLAYTON & CO.

ORDER ALLOWING CERTIORARI. Filed February 7, 1955.

The petition herein for a writ of certiorari to the United States Court of Appeals for the Claims Circuit is granted, and the case is transferred to the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1955 [illegible] 1144

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HAROLD B. WILLEY, Clerk

No. — 26

In the Supreme Court of the United States

OCTOBER TERM, 1954

UNITED STATES OF AMERICA, PETITIONER

v.

ANDERSON, CLAYTON & CO.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

SIMON E. SOBELOFF,
Solicitor General,
Department of Justice, Washington 25, D. C.

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CITATIONS

Cases:

Allen v. *National Manufacture & Stores Corp.*, 125 F. 2d 239, certiorari denied, 316 U. S. 679 — 9

Aviation Capital v. *Pedrick*, 148 F. 2d 165, certiorari denied, 326 U. S. 723 — 9

Batten, Barton, Durstine & Osborn, Inc. v. *Commissioner*, 9 T. C. 448 — 11

Brockman Oil Well Cementing Co. v. *Commissioner*, 2 T. C. 168 — 11

Brown Shoe Co. v. *Commissioner*, 133 F. 2d 582 — 9

Brown Shoe Co. v. *Commissioner*, 45 B. T. A. 212 — 10

Burrus Mills v. *Commissioner*, 22 T. C. No. 107 — 10, 13

Cluett, Peabody & Co. v. *Commissioner*, 3 T. C. 169 — 11

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In the Supreme Court of the United States

OCTOBER TERM, 1954

No. —

UNITED STATES OF AMERICA, PETITIONER

v.

ANDERSON, CLAYTON & CO.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

The Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the United States Court of Claims, entered in the above case on July 13, 1954.

OPINION BELOW

The opinion of the Court of Claims (App. 1a–10a) is reported at 122 F. Supp. 837.

JURISDICTION

The judgment of the Court of Claims was entered on July 13, 1954. (App. 1a.) A motion on behalf of the United States for a new trial or for a rehearing was denied on October 5, 1954. (App. 20a.) The jurisdiction of this Court is invoked under 28 U. S. C. 1255.

QUESTION PRESENTED

Whether, under Section 22 (a) of the Internal Revenue Code of 1939, a corporation is taxable upon the gain it realizes from sales of its "treasury stock", *i. e.*, sales of its own stock which, after original issuance, it reacquires, holds in its treasury, and later sells.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

> SEC. 22. GROSS INCOME.
>
> (a) [As amended by Section 1 of the Public Salary Tax Act of 1939, c. 59, 53 Stat. 574] *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing) of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, mmerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *
> (26 U. S. C. 1952 ed., Sec. 22.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

SEC. 29.22 (a)–15. *Acquisition or Disposition by a Corporation of its Own Capital Stock.*—Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

But if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of the Internal Revenue Code.

STATEMENT

The facts, as found by the court below (App. 10a–19a), may be summarized as follows:

The taxpayer, a Delaware corporation, with its principal office in Houston, Texas, was organized on December 31, 1929. Its original capitalization consisted of $25,842,375 of first preferred stock and $100,000 in common stock. The common stock, consisting of 100,000 shares with a stated value of $1 per share, was issued to its chief managing officials, 44,800 being issued to W. L. Clayton, 31,000 to M. D. Anderson, and the remainder, in varying amounts, to ten minor officials. The common stock was issued to the managing officials as part of a plan to reward and retain competent management, an objective which was deemed by the taxpayer of primary importance to the success of its cotton merchandising business. (App. 10a–11a.)

From the beginning, it was understood by the holders of the common, all of whom were active in the business, that that stock could not be sold to persons other than the managing executives, and that even within that group disposition was to be made according to their respective responsibilities and contributions to management, as determined by the holders of at least 75% of the common stock. It was further understood that no stockholder was entitled to sell his stock, or to keep it, except as directed by the holders of at least 75% of the common stock, and that the respective interests of the holders of the common stock would be ad-

justed among the managerial group as responsibilities changed. (App. 11a.)

In 1931, these restrictions upon the holding of the common stock were embodied in a written agreement between the taxpayer and all the common stockholders. That agreement required the holders of the common stock to endorse their stock to Anderson, as trustee, for a period of ten years, but they retained the right to vote their stock, and to receive dividends thereon. The agreement further provided that upon the death of any common stockholder, the taxpayer would purchase his stock at the book value as of the preceding July 31, adjusted (for appreciation or depreciation of assets) by the taxpayer's executive committee in accordance with the contract. That same adjusted book value was to be used (in the absence of an agreement as to price) as the price at which the taxpayer would acquire the stock of any stockholder desiring to withdraw or required to sell his stock. (App. 12a–13a.) The agreement continued in effect during the taxable year here involved, having been extended in 1943 by another instrument, which altered the provisions relative to the price at which the common stock would be acquired by the taxpayer upon the death or withdrawal of a member or upon a requested sale, so as to provide that common stock would be purchased at $1 per share

plus its proportionate interest in certain surplus accounts (established in accordance with the effective certificate of incorporation of the taxpayer), as determined by its board of directors as of the preceding July 31 (App. 15a–16a).

From time to time, as junior officials assumed more responsibilities and duties, common stock was transferred to them by Clayton and Anderson in accordance with the agreement, so that upon his death in 1939 Anderson held only 18,574 shares of the 31,000 originally issued to him. On December 15, 1939, the taxpayer purchased those 18,574 shares from his estate at $50.79 per share, its valuation under the contract. (App. 13a–14a, 15a, 17a.) During its fiscal year ending July 31, 1944 (the taxable year involved), the taxpayer sold to five of its officials at $112.68 per share, 6,500 of the 18,574 shares which it had acquired from the Anderson estate. No part of the $402,285 difference between the total sales price of $732,420 and the amount of $330,135 which it had paid to the Anderson estate for the 6,500 shares was reported by the taxpayer for income tax purposes.[1] (App. 14a–15a.)

During the taxable year, the taxpayer had no authorized, unissued capital stock.[2] The common

[1] On its books, taxpayer credited the difference to an account called "Capital Surplus." See Finding 14, App. 14a–15a; cf. Finding 23, App. 17a.

[2] No preemptive rights existed as to common stock, which could be issued at the discretion of the board of directors (App. 15a).

stock bought from time to time from shareholders[3] was not cancelled or retired, but held in the treasury. Treasury stock was not voted at meetings of stockholders, nor taken into account in the payment of dividends or in arriving at book value under the agreement, nor was it reflected as an asset in taxpayer's financial statements. (App. 18a,)

The purchase of the 18,504 shares from the Anderson estate in 1939 was in conformity with the plan that the common stock be held only by active management, and it was not for the purpose of investment (App. 18a). The sale of the 6500 shares during the taxable year was to adjust the respective holdings of the taxpayer's officials in accordance with responsibility, and to reward managerial performance by the ownership of common stock which would keep cash in the business and compel the executives to acquire the proprietary interest deemed essential (App. 18a–19a).[4]

[3] Between 1932 and 1943, taxpayer on fifteen occasions purchased shares of its own common stock or sold shares held in its treasury. (See Ex. No. 2, Tr. 3–4.)

[4] The Court of Claims also included in its findings of fact (see Nos. 28 and 29, App. 18a–19a) statements to the effect that the purchase and sales in question were not made by the taxpayer for the purpose of dealing in its stock as it would in the stock of another corporation, but those statements are in our view conclusions of law phrased in the words of the applicable Regulations (Sec. 29.22 (a)–15 of Treasury Regulations 111, *supra*, p. 3).

Similarly the statement by the court in Finding 27 (App. 18a) that "the respective purchases and sales of common stock

The Commissioner of Internal Revenue determined that the taxpayer during the taxable year realized a long term capital gain in the amount of $402,285.00 from the sale of the 6500 shares in question, on which the tax was $106,571.25, and (with adjustments not here material) determined a deficiency of $89,337.66, which was paid by the taxpayer. (App. 19a.) After rejection of its claim for refund (App. 19a), the taxpayer instituted the present action. The Court of Claims, considering that the purchase and sale of the treasury stock was a capital transaction and that the taxpayer was not dealing in its own shares as it might in the shares of another corporation, rendered judgment in taxpayer's favor (App. 1a–10a, 20a). A timely petition for rehearing or for a new trial was filed by the United States and was denied by the court without opinion (App. 20a).

REASONS FOR GRANTING THE WRIT

1. There is a square, express conflict between the decision below and decisions of the courts of appeals for six circuits arising under statutory provisions and regulations identical to those involved in the instant case. *Commissioner* v. *Batten, Barton, D. & O.*, 171 F. 2d 474 (C. A. 2d),

amounted in substance, in the case of purchases by the corporation, to the withdrawal by the stockholder of earnings accumulated during the period of the ownership of such stock, and in the case of sales by the corporation to new managers to a contribution of capital in an amount equal to accumulated earnings" is a conclusion of law.

certiorari denied, 338 U. S. 816; *Aviation Capital* v. *Pedrick*, 148 F. 2d 165 (C. A. 2d), certiorari denied, 326 U. S. 723; *Commissioner* v. *Air Reduction Co.*, 130 F. 2d 945 (C. A. 2d), certiorari denied, 317 U. S. 681; *Commissioner* v. *H. W. Porter & Co.*, 187 F. 2d 939 (C. A. 3d); *Allen* v. *National Manufacture & Stores Corp.*, 125 F. 2d 239 (C. A. 5th), certiorari denied, 316 U. S. 679; *Commissioner* v. *Landers Corp.*, 210 F. 2d 188 (C. A. 6th); *Commissioner* v. *Rollins Burdick Hunter Co.*, 174 F. 2d 698 (C. A. 7th); *Helvering* v. *Edison Bros. Stores*, 133 F. 2d 575 (C. A. 8th), certiorari denied, 319 U. S. 752; *Brown Shoe Co.* v. *Commissioner*, 133 F. 2d 582 (C. A. 8th); *United States* v. *Stern Bros. & Co.*, 136 F. 2d 488 (C. A. 8th). In addition, the decision below is in conflict in principle with the decision of another circuit, under an earlier regulation, *Commissioner* v. *S. A. Woods Mach. Co.*, 57 F. 2d 635 (C. A. 1st), certiorari denied, 287 U. S. 613.[5]

The square conflict of decisions was conceded by the court below. "Notwithstanding the uniformity of the decisions of the Circuit Courts on this issue," said the court, "we are unable to agree with them" (App. 9a). Instead, the court announced that it would follow the inter-

[5] The decision of the Court of Claims in the instant case is also inconsistent with its own prior decision in *Edwin L. Wiegand Co.* v. *United States*, 60 F. Supp. 464. While the court in its opinion stated that this case was "distinguishable on its facts" (App. 9a), we are unable to find any factual differences which warrant a difference in result.

pretation of the regulation which the "Tax Court, notwithstanding reversals, has for a number of years uniformly" adopted (App. 7a). But the day after the decision below was filed the Tax Court, in *Burrus Mills, Inc.* v. *Commissioner*, 22 T. C. No. 107, with five judges dissenting, abandoned its former position and held for the Government "following the Courts of Appeals decisions" on this issue. The decision of the court below, therefore, now stands alone against an array of contrary holdings by all other courts which have considered the question.

The courts of appeals, as noted by the court below, have uniformly held that when a corporation reacquires some of its previously issued stock, retains it in its treasury without retiring or cancelling it, and later sells it at a profit, without any change in its capital structure, it derives a taxable gain. The Tax Court, on the other hand, with some exceptions,[6] has, until the *Burrus Mills* case, held that if a corporation reacquires and then sells (after holding in its treasury) shares of its own stock for such purposes as satisfying contract obligations with or amongst stockholders, equalizing share holdings, eliminating participants desiring to withdraw, implementing

[6] Compare with the cases cited in note 7, *infra*, *M. Conley Co.* v. *Commissioner*, 6 T. C. 250; *Superheater Co.* v. *Commissioner*, decided March 17, 1943 (1943 P-H, T. C. Mem. Dec. 43,129); *Brown Shoe Co.* v. *Commissioner*, 45 B. T. A. 212, and *Pittsburgh Laundry, Inc.* v. *Commissioner*, 47 B. T. A. 230.

employee profit-sharing plans, rewarding deserving employees, or keeping ownership within a particular group, etc., no taxable gain or loss is realized."

2. The decision of the court below is believed to be erroneous and the contrary decisions of the courts of appeals (and now the Tax Court) to be correct.[7] The pertinent regulations, which have been in effect since 1934, provide that "if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another." Reg. 111, Sec. 29.22 (a)–15, *supra*, p. 3. The Commissioner has consistently interpreted this regulation to mean that transactions by a corporation which purchases its own shares and later resells them (without any readjustment in its capital structure) shall have the same tax consequences as dealings by the corporation in any other asset, including the stock of another

[7] See *Batten, Barton, Durstine & Osborn, Inc.* v. *Commissioner*, 9 T. C. 448, reversed, 171 F. 2d 474 (C. A. 2d); *Rollins Burdick Hunter Co.* v. *Commissioner*, 9 T. C. 169, reversed, 174 F. 2d 698 (C. A. 7th); *H. W. Porter & Co.* v. *Commissioner*, 14 T. C. 30, reversed, 187 F. 2d 939 (C. A. 3d); *The Landers Corp.* v. *Commissioner*, decided June 9, 1952 (1952 P-H T. C. Mem. Dec. ¶52,172), reversed, 210 F. 2d 188 (C. A. 6th), in which the Tax Court had continued to follow its earlier decisions in *Dr. Pepper Bottling Co. of Miss.* v. *Commissioner*, 1 T. C. 80; *Brockman Oil Well Cementing Co.* v. *Commissioner*, 2 T. C. 168, and *Cluett, Peabody & Co.* v. *Commissioner*, 3 T. C. 169.

corporation. This interpretation is consistent with the broad scope of Section 22 (a) of the Internal Revenue Code of 1939, which declares subject to tax "gains, or profits and income derived from any source whatever." It also recognizes that, so long as there is no readjustment in fact in the capital structure of the corporation concerned, the economic gain or loss to the corporation is the same whether it buys and sells its own shares, those of another corporation, or any other asset, and whether or not the making of profits was the purpose of the transactions in question. Nor is the difference between sales of treasury stock and sales of unissued stock one of form alone, as suggested by the court below (App. 8a, 10a).[5] The incidence of taxation in the former case and not the latter is supported, *inter alia*, by the freedom a corporation has in acquiring and disposing of treasury shares as contrasted with the statutory and charter requirements which commonly surround the issuance of new shares.

3. The issue raised by this case presents an important problem in the administration of the revenue law which will be a recurring problem for a number of years to come. Although Section 1032 of the Internal Revenue Code of 1954 pro-

[5] This suggestion was expressly rejected by the Court of Appeals for the Sixth Circuit in *Commissioner* v. *Landers Corp.*, 210 F. 2d 188. See also *Commissioner* v. *Batten, Barton, D. & O.*, 171 F. 2d 474, 476 (C. A. 2d).

vides that "No gain or loss shall be recognized to a corporation on the receipt of money or other property in exchange for stock (including treasury stock) of such corporation", this settles the law only for years after 1953.[9] The present case involves the taxable year ending July 31, 1944. The tax consequences of gains or losses on dealings in treasury stock during the intervening years for this and all other corporations which have used this common and convenient device for controlling the identity of shareholders, rewarding management, etc., remain to be resolved. Two cases are now pending in the Fifth[10] and Sixth[11] Circuits, respectively, on petition for review of decisions of the Tax Court. The Commissioner of Internal Revenue has informed us that at least nine other cases are pending and that undoubtedly additional cases will arise on audit or as a result of claims filed on the basis of the instant decision of the Court of Claims. These cases, moreover, commonly involve a substantial amount of tax. Thus the tax

[9] It may be noted that the reports of the Congressional Committees concerning that section state that its purpose was "to remove the uncertainties of present law". H. Rep. No. 1337, 83d Cong., 2d Sess., p. A268; S. Rep. No. 1622, 83d Cong., 2d Sess., p. 426. But the only uncertainty in the law at the time of those reports (March 9 and June 18 of 1954, respectively) was caused by the persistent adherence of the Tax Court to the position which it has since abandoned.

[10] *Burrus Mills, Inc.* v. *Commissioner*, 22 T. C. No. 107, petition for review filed by taxpayer, Nov. 26, 1954.

[11] *Timken-Detroit Axle Co.* v. *Commissioner*, 21 T. C. 769, petition for review filed by Commissioner, July 12, 1954.

involved in the 12 pending cases, including the instant case, totals in excess of $830,000. Accordingly we believe that this case presents an important question which should be resolved by this Court.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

SIMON E. SOBELOFF,
Solicitor General.

JANUARY 1955.

APPENDIX

229864—54

APPENDIX

In the United States Court of Claims

No. 626-52

(Decided July 13, 1954)

ANDERSON, CLAYTON & CO. v. THE UNITED STATES.

Mr. John C. White for plaintiff.

Mr. John A. Rees, with whom was *Assistant Attorney General H. Brian Holland*, for defendant. *Messrs. Andrew D. Sharpe* and *Lee A. Jackson* were on the brief.

OPINION

LITTLETON, *Judge*, delivered the opinion of the court:

Plaintiff sues to recover $100,571.25 with interest thereon as provided by law. The principal sum represents the income tax assessed by the Commissioner of Internal Revenue and paid by plaintiff on the $402,285 difference between the amount at which plaintiff purchased 6,500 shares of its capital stock from a deceased official in 1939 and the amount at which it sold and reissued the stock to other officials during its fiscal year ending July 31, 1944. Plaintiff takes the position that no taxable long term capital gain resulted from the transaction because plaintiff was not dealing in the stock as it might have in the shares of another corporation, and that under the provisions of section 22 (a) of the Internal Revenue Code and section 29.22 (a)-15 of Treasury Regulation 111, all the facts and circumstances surrounding the transaction show that no taxable gain arose to plaintiff.

326864—54——3

Defendant contends that Regulation 111, section 29.22 (a)–15 does not entitle plaintiff to recover as that regulation has been construed by the Circuit Courts of Appeal for several circuits on facts sufficiently similar to the facts in this case to be persuasive.

Section 22 (a) of the Code provides:

> GENERAL DEFINITION.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

Regulation 111, section 29.22 (a)–15 provides:

> *Acquisition or disposition by a corporation of its own capital stock.*—Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.
>
> But if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of the Internal Revenue Code.

The facts as stipulated by the parties may be summarized as follows: Plaintiff was organized in 1929 as a cotton

merchandising business with a capitalization of $25,842,375 of first preferred stock and $53,312.50 of common stock. In 1930 an additional 46,687½ shares of common stock were sold at $1 per share, making the total common stock outstanding 100,000 shares. The capital value of the no par value common stock was fixed at a stated value of $1 per share and was sold at that price to the managing officials of the corporation. No preemptive rights existed as to the common stock.

Because of the complex nature of the cotton merchandising business and the essentiality of long experience for its top executives in all phases of the business, it was decided to use the common stock of the corporation as a means to attract, retain, and incite incentive in such top officials. In 1931 a written agreement was entered into between the corporation and the various company officials who owned all the common stock whereby each of the owners endorsed his stock to Monroe D. Anderson as trustee for a period of 10 years, which period was subsequently extended, with the stockholders retaining the right to vote the stock and receive dividends thereon. The agreement provided that the stockholders would not assign, transfer, or otherwise dispose of their stock without the written consent of the holders of 75 percent of the stock; that on the death of any party to the agreement the corporation would purchase the stock of the deceased person at the special book value determined as of July 31 immediately preceding the death according to the provisions contained in the agreement relative to the annual determination of value by the executive committee of the corporation, but in no event less than $1 per share, plus 6 percent interest from such date to the date of death. The value of the trusteed stock was to be determined annually from a supplementary balance sheet which had been adjusted to show appreciation and depreciation of the value of properties held by the corporation and its subsidiaries to reflect its true net worth. The owners of 75 percent of the stock could request any party to the agreement to sell all or part of his stock to the corporation or to such person as the owners of the 75 percent might designate, either upon terms agreeable to

seller and buyer or in the absence of such agreement, at the value fixed for the stock in the annual supplementary balance sheet. Any owner of the stock could sell his stock to the corporation at any time upon the same terms. Any common stock purchased by the corporation under the agreement could be sold to the remaining parties or to any other person whom the owners of 75 percent of the remaining stock might designate. A more complete summary of the agreement is set forth in finding 6.

As junior officials in the corporation assumed more responsibilities W. L. Clayton, and M. D. Anderson who at first had owned the bulk of the trusteed stock, transferred shares of their stock to such junior officials in accordance with the provisions of the agreement. At Mr. M. D. Anderson's death in 1939, he held only 18,574 shares of the 31,000 originally issued to him. All transfers of the stock were made to persons occupying positions of managerial responsibility in the business and at the values determined under the agreement.

Upon the death of Mr. Anderson, the plaintiff corporation purchased his 18,574 shares at the contract value of July 31, 1938, which with interest, amounted to $50.79 a share or a total of $943,373.46. The cost over the $1 stated value of 15,539 of these shares was charged to the Surplus Allocated to Common Stock account. The remaining 3,035 shares of this particular stock were sold to another company official in accordance with the agreement, based on the July 31, 1939, contract value of $32.27 a share and the net "loss" of $18.52 a share or $56,208.20 was charged directly to the Surplus Allocated to Common Stock account. This stock was not retired but was held as treasury stock. While in the treasury no dividends could be paid on it and it could not be voted. Also 1,000 of these shares were sold in 1941 at $33.62 a share and the $32,620 over stated value was credited to the Surplus Allocated to Common Stock account reflecting a "loss" of $17,170 on these shares. Although the corporation sold some of these shares for less than it had paid the deceased official's estate for them, this amount was not deducted from income but was reflected in Surplus as above stated, which resulted only in a smaller Surplus Allocated to

Common Stock, maintaining the equity for all common stockholders equivalent to that existing before the sales.

In December 1943, the corporation and its stockholders decided to sell 6,500 shares of the Anderson Estate stock to five of the corporation's junior officials at $112.68 a share, which was the July 31, 1943, supplementary balance sheet value less a $10 dividend payable to the old common-stock holders. The amount over the $1 stated value was credited to the Capital Surplus account (plaintiff relabeled and consolidated some of its surplus accounts) and no income was reported. It is the difference, $402,285, between the amount paid the Anderson Estate in 1939 for the stock and the price at which the stock was transferred to the junior managing officials during the fiscal year ending July 31, 1944, that the Commissioner of Internal Revenue determined to be a taxable long-term capital gain. Timely claim for refund was made, and denied.

Plaintiff points out that under its certificate of incorporation and the trust agreement between itself and its common-stock holders, the transaction in question amounted in substance to the payment to the deceased stockholder of his capital contribution plus his share of undistributed earnings, and in the case of the sale to the new officials, to the equalization of their capital investment with that of the other common-stock holders as represented by the outstanding shares before the sale. Plaintiff contends that when the real nature of the transaction is considered it certainly was not dealing in its own shares as it might in the shares of another corporation and that if the first and third sentences of the Regulation mean anything, they must have been intended to exclude from taxation any gain resulting therefrom.

Prior to 1934 the law on taxable gain or loss on the acquisition and sale of a corporation's own stock was relatively clear. The Commissioner's regulations provided that no gain or loss was realized from a corporation purchasing or selling its own stock.[1] This rule was reasonable, logical

[1] U. S. Treas. Reg. 45, Art. 542 (1918 Act); U. S. Treas. Reg. 62, Art. 543 (1921 Act); U. S. Treas. Reg. 65, Art. 543 (1924 Act); U. S. Treas. Reg. 69, Art. 543 (1926 Act); U. S. Treas. Reg. 74, Art. 66 (1928 Act); U. S. Treas. Reg. 77, Art. 66 (1932 Act).

and in accord with the accountant's view.[2] The First Circuit in 1932, in its opinion in *Commissioner* v. *Woods Machine Co.*, 57 F. 2d 635, laid the groundwork for the Commissioner to make a complete about-face insofar as the taxation of treasury stock was concerned. On May 2, 1934, T. D. 4430 [XIII-1 C. B. 36] was promulgated amending the regulations to provide, with certain exceptions not here material, as they do today. Although the retroactive application of the part pertinent herein of the regulation was held invalid by the Supreme Court, the Court did not decide whether its prospective application would be valid. *Helvering* v. *Reynolds Co.*, 306 U. S. 110. The validity of this regulation has been specifically sustained or assumed to be valid by the Circuit Courts[3] and this court[4] although apparently no real distinction can be made between the sale of unissued stock, which is unquestionably a capital transaction resulting in the realization of no income or loss, and the sale of treasury stock. Treasury stock is not subjected to as high a stamp tax, is nonassessable, and is free from preemptive rights and sales price restrictions. It may be noted in this respect that the common stock of plaintiff corporation was no-par-value stock and carried no preemptive rights on original issue. None of these distinctions appear relevant in determining whether the sale of treasury stock is a capital transaction. Insofar as the corporation is concerned the sale of unissued stock and the sale of treasury stock each involve a contribution of capital by the stockholder to the corporation with the

[2] Paton, Accountant's Handbook (3rd ed.), pp. 1006-1014; Report of the Committee on Accounting Procedure (American Institute of Accountants 62 J. Accountancy 417 (1938); Security and Exchange Commission Accounting Series, Release No. 6 (1938).

[3] *Allen* v. *National Manufacture & Stores Corp.*, 125 F. 2d 239, certiorari denied, 316 U. S. 679; *Aviation Capital* v. *Pedrick*, 148 F. 2d 165, certiorari denied, 326 U. S. 723; *Brown Shoe Co.* v. *Commissioner*, 133 F. 2d 582; *Commissioner* v. *Air Reduction Co.*, 130 F. 2d 145, certiorari denied, 317 U. S. 681; *Commissioner* v. *Batten, Barton, Durstine & Osborn, Inc.*, 171 F. 2d 474, certiorari denied, 338 U. S. 816; *Commissioner* v. *Landers Corp.*, 210 F. 2d 188; *Commissioner* v. *H. W. Porter & Co.*, 187 F. 2d 939; *Commissioner* v. *Rollins Burdick Hunter Co.*, 174 F. 2d 698; *Dow Chemical Co.* v. *Kavanagh*, 129 F. 2d 42; *Helvering* v. *Edison Bros. Stores*, 133 F. 2d 575, certiorari denied, 319 U. S. 752; *United States* v. *Stern Bros. & Co.*, 136 F. 2d 488. Judge Frank, in a concurring opinion in *Commissioner* v. *Batten, Barton, Durstine & Osborn, Inc.*, *supra*, after stating that it was irrational to ever consider treasury stock as a capital asset said: "The situation then, to my mind, is like that in a farce: An untenable premise, once adopted, is to be carried out logically."

[4] *Wiegand Co.* v. *United States*, 194 C. Cls. 111.

corporation incurring the same obligation and duties to the stockholder, and the purchase of the stock for retirement and resale each involve a repayment of capital to the stockholder by the corporation. Cf. *E. R. Squibb & Sons* v. *Helvering*, 98 F. 2d 69. Also, treasury stock, like unissued stock, does not have an intrinsic value, but merely represents the power and right to issue additional stock. While in the treasury this stock earns nothing for the corporation, dividends are not paid on it, nor does it carry voting or any of the other rights incident to outstanding stock. It would be a courageous step to hold that a corporation can never realize income on the sale of treasury stock because it is a capital transaction. We do not find it necessary to consider whether this step should be taken because the plaintiff is entitled to recover under the plain terms of the regulation as we construe it.

The Commissioner's position that income may be realized by a corporation on the sale of treasury stock may be justified on the ground that as a practical matter some corporations do deal in their own stock just as though it were an asset, buying it, holding it as an investment, and selling it at opportune times. That is the type of situation that we believe the portion of the regulation here in question covers.

The Tax Court, notwithstanding reversals, has for a number of years uniformly applied this regulation literally and examined the real nature of the transaction considering all the facts and circumstances in determining whether or not the transaction resulted in a taxable gain. The Tax Court maintains the position that if a corporation buys and sells its own shares for the purpose of satisfying contractual obligations, equalizing shareholdings, eliminating a participant wishing to retire, implementing an employee profit sharing plan, or keeping the ownership of the corporation within a particular group, the corporation is not dealing in its own shares as it would in another corporation because the treasury shares are not treated as assets and are not bought and sold for the purpose of making a profit, and accordingly holds that no taxable gain or loss is realized.[1]

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[1] *Dr. Pepper Bottling Co. of Miss.*, 1 T. C. 80; *Brockman Oil Well Cementing Co.*, 2 T. C. 168; *Cluett, Peabody & Co., Inc.*, 3 T. C. 169; *Rolling Burdick Hunter Co.*, 9 T. C. 169, *rev'd* 174 F. 2d, 698; *Batten, Barton, Durstine &*

The Circuit Courts of Appeal have, with equal uniformity, with some judges dissenting, adopted the position that unless the corporation repurchasing its own stock legally retires it according to State law and issues new stock, the transaction results in taxable gain or loss to the corporation.[6]

We agree with the Tax Court's position because: (1) we entertain some doubt as to whether a corporation's purchasing and selling its own stock is not really a capital transaction, (2) the basis for the Circuit Courts' decisions is one of form only in that it rests entirely on the failure of the corporation to go through the formal mechanics of actually retiring the stock and issuing new stock, and (3) the plain terms of the regulation support the Tax Court's position. When the regulation is viewed in this light, plaintiff falls comfortably within the language and purview of the regulation. The plaintiff did not purchase the stock at opportune times. It was obligated by contract to repurchase the stock when a stockholder died, at a price equal to the book value of the stock as determined from a supplementary balance sheet reflecting the true net worth of the corporation. This is how the stock in question was purchased by the corporation. The corporation was also obligated to purchase the stock of any common-stock holder who left the corporation, or for any reason withdrew from the agreement, at a negotiated price or in the event of their inability to agree, at the price determined similar to that of a deceased stockholder. The time of sale was clearly not dictated by profit on the sale of the stock. As a matter of fact some of the stock was sold at a "loss," and the approval of 75 percent of the common-stock holders was required for these transactions. The provisions of the certificate of incorporation and the trust agreement were designed to attract, retain, and incite incentive in competent officials, which were a necessity because of the complex nature of its business. The common stock was trusteed under conditions that assured its receipt and retention by only active management and its redistribution according to changing managerial responsibility.

Osborn, Inc., 9 T. C. 438, *rev'd* 171 F. 2d 474; *H. W. Porter & Co.*, 14 T. C. 307, *rev'd* 187 F. 2d 939; *The Landers Corp.*, 11 T. C. M. 577, *rev'd* 210 F. 2d 186; *Timken-Detroit Axle Co.*, 21 T. C. No. 85 (decided Feb. 26, 1954).

[6] See footnote 3.

Pursuant to its certificate of incorporation and the trust agreement, plaintiff purchased Mr. M. D. Anderson's 18,574 shares at his death in 1939, for the contract value of $50.79 a share. In 1943, in accordance with plaintiff's policy, it sold 6,500 of these shares to junior officials of the corporation for $112.68 a share, which was the contract value less a $10 dividend payable to the old common-stock holders. This differential, which the Commissioner claims should be taxed, represents largely, if not entirely, accumulated earnings of the corporation which have already been subjected to tax. The respective purchases and sales of this common stock amounted in substance (1) in the case of purchases by the corporation, to the withdrawal by the stockholder of his capital contribution plus his undistributed earnings accumulated during the period of his ownership of such stock, and (2) in the case of sales by the corporation to new managers, to a contribution of capital in an amount equal to the existing stockholder's contributed capital plus accumulated undistributed earnings so as to equalize the equity of all common-stock holders and the distributions thereafter during the ownership of such stock by the executive permitted to buy it. On these facts it is rather difficult to comprehend how plaintiff corporation realized an accession to income. Upon examining the real nature of the transaction, considering all the facts and circumstances, we arrive at the conclusion that plaintiff was not dealing in its own shares as it might in the shares of another corporation.

The *Wiegand Co.* v. *United States* case, 104 C. Cls. 111, upon which defendant relies, is distinguishable on its facts.

Notwithstanding the uniformity of the decisions of the Circuit Courts on this issue, we are unable to agree with them. To say that there is a taxable gain merely because there is a difference between the purchase and sales price is really to assume the question in issue. There also can be a difference in the cost of stock retired and the price at which new stock is issued, but the resulting difference is not taxable or deductible because it is a capital transaction. Consequently, the question that confronts the court in these cases, assuming the regulation to be valid, is whether the

treasury stock was treated in substance as an asset rather than stock of the corporation. To do this requires an examination of all the facts and circumstances of the case. Although the Circuit Courts' view, considering the one factor of failing to actually retire the stock as controlling, is an expeditious method of determining taxability of treasury stock, it must be conceded that this distinction between treasury stock and unissued stock is one of form. Moreover, it would be equally expeditious to hold that the acquisition and sale of a corporation's own stock was a capital transaction, since it does as a practical matter result in readjustment of capital and find support in the famous case of *Eisner* v. *Macomber*, 252 U. S. 189. We therefore conclude that plaintiff is entitled to recover $100,571.85 plus interest allowed by law.

It is so ordered.

MADDEN, *Judge*; WHITAKER, *Judge*; and JONES, *Chief Judge*, concur.

Judge LARAMORE took no part in the consideration or decision of this case.

FINDINGS OF FACT

The court, having considered the evidence, the briefs and argument of counsel, and the report of Commissioner Wilson Cowen, makes the following findings of fact:

1. The plaintiff, Anderson, Clayton & Co., is a corporation organized on December 31, 1929, and existing under the statutes of the State of Delaware, with its principal business office at Houston, Texas.

2. Upon the organization of Anderson, Clayton & Co. in 1929, the corporation issued $25,842,375 of its 6½ percent preferred and 53,312½ shares of its common stock, the capital value of which was fixed at $1 per share, in exchange for 34,875 shares of the Texas joint stock association, also known as Anderson, Clayton & Co., which thereafter dissolved. On or about April 21, 1930, an additional 46,687½ shares of common stock were sold at $1 a share to the managing officials of the corporation resulting in the following total common stock ownership by the chief managing officials:

W. L. Clayton	44,800
M. D. Anderson	31,000
Lamar Fleming, Jr.	12,000
Harmon Whittington	5,000
D. B. Cannafax	2,750
L. L. Fleming	2,500
Six minor officials	1,950
	100,000

3. The original capitalization of the corporation, i. e., $25,842,375 of first preferred stock and $100,000 in common stock, was designed to have existing values represented by preferred stocks and to utilize the 100,000 shares of $1 common to adjust the participation of the managing officials in future earnings above the contracted return on first preferred.

4. Cotton merchandising is primarily a management business and is regarded as one of the most difficult and complex merchandising operations in the world. The results of a whole year's business depend upon difficult day-to-day decisions by top executives as to the purchase and sale of spot cotton and the placement of hedges upon domestic and foreign futures exchanges. Long experience in all phases of the cotton business is almost essential to the success of a top cotton executive. It is difficult to obtain executives from other fields who can capably manage a cotton business.

5. The ownership of the common stock was surrounded with restrictions which were designed to insure its holding and use as a method of rewarding management. From the beginning it was understood by the common-stock holders, all of whom were active in the business, that the stock was not salable outside the managing directors of the business, and that even within that group the disposition was to be made in accordance with the responsibilities of and contributions to management by the different executives as determined by the holders of at least 75 percent of the common stock. It was understood that no stockholder was entitled to sell his stock and none could keep it unless the others wanted him to. It was likewise understood from the beginning that the respective interests in the common stock would be adjusted among the managerial group as responsibility changed.

6. On February 14, 1931, an agreement in writing was entered into between the corporation and the holders of all its common stock, all of whom were actively engaged in the business. This instrument embodied, among other things, the provisions of the general understanding theretofore existing among the common-stock holders with reference to the restrictions upon the holding of the stock and the plan for its use as a method of rewarding management. The agreement provided, in substance, that:

(1) All the common-stock holders of the corporation agreed to endorse their common stock to Monroe D. Anderson as trustee for a period of 10 years.

(2) The stockholders retained the right to vote their stock.

(3) The stockholders agreed that they could not assign, transfer, or otherwise dispose of their common stock without the written consent of the holders of 75 percent of the stock.

(4) On the death of any party to the agreement, the corporation agreed to purchase the common stock of the deceased party at the value determined as of July 31, immediately preceding the death, according to the provisions made in the contract for the annual determination of value by the executive committee of the corporation, but in no event less than $1 per share, plus six percent interest from such date to the date of death.

(5) A consolidated balance sheet for the corporation and all its subsidiaries was to be prepared as of July 31 of each year (the end of its fiscal year); and, in addition, for the private use of the individual parties to the agreement, a supplementary balance sheet, adjusted on account of appreciation and depreciation of the value of properties held by the corporation and its subsidiaries so as to reflect the true net worth of the corporation (without any allowance for good will), was also to be prepared and approved by the executive committee of the corporation as soon after the end of each fiscal year as practicable. The value of the common stock as shown in the supplementary balance sheet was to be fixed as the value of that stock for purposes of the contract.

(6) The owners of 75 percent of the common stock could at any time in writing request any party to the agreement to sell all or any part of his common stock to the corporation, or to such person as they might designate, upon terms agreeable to seller and buyer; and if seller and buyer could not agree, then according to

the value fixed for the common stock in the annual supplementary balance sheet approved by the executive committee, as in the case of the death of any party to the contract.

(7) Any owner of common stock held by the trustee under the agreement could elect at any time to withdraw and sell his common stock to the corporation upon terms mutually agreeable by giving written notice of his desire to the trustee. If the corporation and the party could not agree upon the selling price, then the value fixed in the annual supplementary balance sheet was to be used, substantially in the same way as in the case of death of a party.

(8) No dividends could be paid on common stock so long as the corporation was indebted in any sum whatever, nor in any event if the dividend would have the effect of lowering the book value of the stock below five million dollars as reflected in the consolidated balance sheet of the corporation, nor unless an amount of preferred stock equal to the dividend was retired at the same time.

(9) Any common stock purchased by the corporation under the terms of the agreement could be sold to the remaining parties to the agreement or to any other person whom the owners of 75 percent of the remaining stock might designate in writing.

(10) Any future holder of common stock could become a party to the agreement merely by signing it or giving his consent to its provisions in writing.

(11) All the parties to the agreement agreed that any common stock thereafter acquired by any of them, in whatever manner, should automatically be subject to all the terms of the agreement and should be endorsed to the trustee.

(12) The agreement could be amended, altered, revised, or canceled at any time by an instrument in writing signed by the owners of 75 percent or more of the common stock.

7. Until the year ending July 31, 1937, the contract value of the common stock was, by authorization and declaration of dividends thereon in second preferred stock, maintained at approximately $1 a share, such course having been abandoned when the Commissioner sought to tax such stock dividends.

8. From time to time also as junior officials assumed more responsibilities and duties, shares of common stock were in pursuance of said agreement and in the ordinary course

of business transferred by W. L. Clayton and M. D. Anderson to junior management officials so that upon his death M. D. Anderson held only 18,574 shares of the 31,000 originally issued to him.

9. All of the transfers of the corporation's common stock were made only to persons who occupied positions of managerial responsibility in the business and at the value determined under the agreement.

10. During its fiscal year ending July 31, 1944, Anderson, Clayton & Co., allocated and sold 6,500 shares of its common stock to the managing officials shown at the contracted valuation of $112.68 a share in recognition of increased responsibility and duties:

Names	Shares	Price
H. Whittington	2,000	$225,360
Sydnor Oden	1,250	140,850
W. H. Koar	1,500	169,020
J. M. Johnson	1,250	140,850
W. E. Parry	500	56,340
Total	6,500	732,420

11. The corporation received in payment the notes of the employees in the form approved by the directors. Counsel stipulated that the $112.68 received might, for the purposes of this case, be treated as though it were a cash sales price.

12. Of the officials to whom the corporation transferred 6,500 shares of the 18,574 purchased from the Estate of M. D. Anderson, Harmon Whittington was the vice-president in charge of trading policies and cotton merchandising activities; W. H. Koar, a vice-president in charge of the New York office and of relations with New York banks; Sydnor Oden, a vice-president in charge of cotton export sales; J. M. Johnson, a vice-president in charge of new plant and industrial activities; and W. E. Parry, the controller and chief accounting officer of the business.

13. The 6,500 shares of stock so allocated and sold was a part of the 18,574 shares acquired by the corporation on December 15, 1939, from the Estate of M. D. Anderson at its contracted supplementary balance sheet valuation of $50.79 per share.

14. The difference, over stated value, between the amount of $330,135 paid the Estate of M. D. Anderson for 6,500

shares at $50.79 a share, its value at the time of the death of M. D. Anderson in 1939, and $732,420, the price at which such stock was transferred to the managing employees mentioned in 1944 at $112.68 a share was credited by plaintiff to Capital Surplus (plaintiff consolidated and relabeled some of its surplus accounts) and no income was reported for income tax purposes.

15. The effective certificate of incorporation of Anderson, Clayton & Co. authorized the issuance of 477,856 shares of stock, of which 300,000 shares, par value $100, was participating four percent cumulative first preferred, 75,000 shares, par value $100, was participating four percent cumulative second preferred stock, and 102,856 shares without nominal or par value was common stock. No preemptive rights existed as to common stock which could be issued at the discretion of the Board.

16. After four percent dividends on the preferred stocks were paid or set aside, the effective certificate of incorporation provided for the establishment of a "Common Stock Surplus" to consist of the undistributed surplus on July 31, 1938, less any unpaid accrued dividends on preferred, increased during each succeeding year by:

(1) Five Dollars per share on all Common Stock outstanding; and

(2) Four percent per annum on the Common Stock Surplus balance.

Any remaining undistributed surplus constituted "Participating Stock Surplus" which after payment of all cumulative preferred dividends and distribution of the entire "Common Stock Surplus" could be distributed as dividends, one-half to the Participating Preferred Stocks and one-half to Common.

17. Upon dissolution assets were distributable, first, to cover the par value and cumulative dividends of preferred stocks, then to common to cover the Common Stock Surplus and an amount of $1 per share, after which all remaining assets were divisible equally between preferred and common.

18. The agreement of February 14, 1931, was continued in effect during the taxable years involved by an instrument executed on April 16, 1943, extending its term until August 1, 1953. Such agreement provided that in case of death the

value of the common stock for the purposes of the agreement should be $1 per share plus the proportionate interest of the stock in the Common Stock Surplus and Participating Stock Surplus determined by the Board of Directors as of the July 31st immediately preceding such death plus four percent from such date to the date of death. It further provided that:

> In determining such proportionate interest there shall be excluded from the common stock surplus the excess of cost of any shares of common stock held as treasury stock over $1.00 per share, and shares held as treasury stock shall be excluded from the total number of shares participating.

Any holder could be required to sell at such price upon request of 75 percent of the holders and upon withdrawal was entitled to payment for his stock at such price.

19. The balance sheet of the corporation as of July 31, 1943, approved by the Directors on November 30, 1943, showed the Capital Stock and Surplus of the corporation as follows:

Capital stock and surplus:		
Participating 4% Cumulative preferred Stock, par value $100.00 per share:		
First preferred, 272,411 shares		$27,241,100.00
Second preferred, 54,441 shares		5,444,100.00
		32,685,200.00
Common stock, no par value, 84,083 shares		84,083.00
Surplus, per annexed statement		14,728,679.65
		47,497,962.65

20. The Common Stock Surplus as of July 31, 1943, was approved as follows:

Common stock surplus:		
Balance at July 31, 1942		$5,079,070.03
Provision for cumulative $5.00 per share and 4% on balance	$623,352.80	
Less adjustment account 665 shares purchased	54,796.84	568,555.96
		5,647,625.99

21. Valuation of the common stock as of July 31, 1943, was determined as follows:

Valuation of stocks:	
Preferred—326,852 shares outstanding, par value	$32,685,200.00
Participating surplus	4,497,212.96
Total value ($113.76 per share)	37,182,412.96
Common—84,083 shares outstanding, paid in value	$84,083.00
Common stock surplus	5,647,625.99
Participating surplus	4,583,840.70
Total value ($122.68 per share)	10,315,549.69

22. When the company bought the 18,574 shares of common stock held by M. D. Anderson at the contract price of $50.79 per share (i. e., the amended value of $48.33 as of July 31, 1938, plus interest to the date of his death), the cost over the $1 stated value of 15,539 shares was charged to Surplus-Allocated to Common Stock. The remaining 3,035 shares were sold on December 22, 1939, to W. L. Anderson at its July 31, 1939, valuation of $32.27 per share, and the difference between the $50.79 cost per share and the $32.27 selling price per share, or $56,208.20, was charged to Surplus-Allocated to Common Stock. When 1,000 shares were sold on February 28, 1941, at $33.62 a share Surplus Allocated to Common Stock was credited with $32,620 (the selling price over stated value, or $32.62 per share), which resulted in a net deficit of $17,170 for these 1,000 shares.

23. Upon the sale of the 6,500 shares of common stock at $112.68 a share, such stock not participating in the dividend of $10 a share just previously declared on the 84,083 shares outstanding, Treasury Stock-Common was credited with the stated value of $6,500 and the excess of cost over stated value of the 6,500 shares sold in the sum of $323,635 [$309,526.16 plus $14,108.84]. Capital Surplus was credited with $725,920, the excess of the sales price over the $6,500 stated value.

24. At the time the Treasury stock was acquired, it was charged at cost, not at stated value, to "Treasury Stock-Common." To prepare balance sheet statements the differ-

ence between the stated value of the stock and its cost was set up in a reserve for valuation, and then the capital account was reduced by the stated value of the outstanding common stock as shown on the balance sheet. The cost of the stock over the stated value was charged to surplus; then when the stock was sold treasury stock was credited with its cost and the difference between cost and sales price was put into surplus.

25. The common stock bought from shareholders was not cancelled or retired but the shares outstanding less those held in the treasury were used in all financial statements, in the payment of dividends, in arriving at the per share values under the agreement. Treasury stock was not voted at meetings of shareholders nor taken into account in payment of dividends. During the taxable year involved there was no authorized unissued stock.

26. The stated $1 per share value of the common stock, which represented its capital under the laws of Delaware, was nominal and the substantial value of such stock was represented by the Common Stock Surplus and the Participating Surplus which amounted to $111.68 per share as of July 31, 1943, after deduction of the $10 dividend declared on November 30, 1943.

27. Under the certificate of incorporation, the agreement between the corporation and its common-stock holders and the method of accounting there required and consistently followed, the respective purchases and sales of common stock amounted in substance, in the case of purchases by the corporation, to the withdrawal by the stockholder of earnings accumulated during the period of the ownership of such stock, and in the case of sales by the corporation to new managers to a contribution of capital in an amount equal to accumulated earnings so as to equalize the common equity of all stockholders and the distributions during the ownership of such stock by the executive permitted to buy it.

28. The purchase of the 18,574 shares of the common stock from M. D. Anderson in 1939 was in conformity with the plan that the common stock should be held only by and sold only to active management. The purchase by the corporation was not for the purpose of investment or to deal in its

common stock as it would the stock of another corporation. Under the stockholders agreement with the corporation such common stock could be sold only to persons and upon such terms as might be agreed upon in writing by the holders of 75 percent of the stock held by the trustee. Such stock could not be issued or transferred by the corporation until the stockholder executed acceptance of the agreement.

29. The sale of 6,500 shares of the common stock to various junior officials in December 1943, was to adjust the respective holdings in the common stock in accordance with responsibility, and to reward managerial performance by the ownership of common stock which would keep cash in the business and compel the executives to acquire the proprietary interest deemed essential, and not for the purpose of dealing in its stock as it would the stock of another corporation.

30. Upon original issuance the corporation received $1 a share for its common stock, or $18,574, for the stock repurchased in 1939 from the M. D. Anderson estate. This repurchase of the 18,574 shares of common stock on December 15, 1939, at $50.79 a share from the M. D. Anderson estate reduced the assets of the corporation by the amount of $943,373.46. The sale of 3,035 shares to W. L. Anderson on December 22, 1939, at $32.27 a share increased the net assets by $97,939.45, and the sale of 6,500 shares at $112.68 a share on November 30, 1943, increased the assets of the company by the amount of $732,420.

31. Following examination, the Commissioner of Internal Revenue determined that Anderson, Clayton & Co. realized a long-term capital gain in the amount of $402,285.00 on which the tax was $100,571.25 and with other adjustments determined a deficiency of $89,337.66, which was paid on August 27, 1947.

32. Claim for refund in the amount of $100,571.25 was executed October 18, 1947, and was filed by plaintiff on October 20, 1947.

33. On or about January 20, 1951, plaintiff received by registered mail an official notice, dated January 18, 1951, of disallowance of its claim of October 18, 1947.

CONCLUSION OF LAW

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes that as a matter of law the plaintiff is entitled to recover.

It is therefore adjudged and ordered that plaintiff recover of and from the United States One Hundred Thousand Five Hundred Seventy-one Dollars and Twenty-five Cents ($100,571.25), with interest as provided by law.

PROCEEDINGS FOLLOWING OPINION OF THE COURT

On August 23, 1954, defendant filed a motion for a new trial or for a rehearing.

On October 5, 1954, the court entered the following order on said motion:

Order

These cases come before the court on motions for rehearings, amendment of judgments or new trials under Rules 53 and 54 of the Rules of this court and, on consideration thereof,

IT IS ORDERED this fifth day of October, 1954, that said motions be and the same are overruled as follows:

* * * * *

626–52 Anderson, Clayton & Co. Defendant's motion.

* * * * *

BY THE COURT:

/s/ Marvin Jones
MARVIN JONES,
Chief Judge.

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In the Supreme Court of the United States

OCTOBER TERM, 1955

No. 26

UNITED STATES OF AMERICA, PETITIONER

v.

ANDERSON, CLAYTON & CO.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

OPINION BELOW

The opinion of the Court of Claims (R. 15-23) is reported at 122 F. Supp. 837.

JURISDICTION

The judgment of the Court of Claims was entered on July 13, 1954 (R. 15). A motion on behalf of the United States for a new trial or for a rehearing was denied on October 5, 1954 (R. 30-31). The petition for a writ of certiorari was filed on December 31, 1954, and was granted on February 7, 1955 (R. 87). The jurisdiction of this Court rests on 28 U.S.C. 1255(1).

QUESTION PRESENTED

Whether a corporation which purchases its own shares, holds them in its treasury, and resells them at a profit is taxable on the gain under Section 22(a) of the Internal Revenue Code of 1939 and the applicable Treasury Regulations.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing) of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U.S.C. 22.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.22(a)-15. *Acquisition or Disposition by a Corporation of its Own Capital Stock.*— Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

But if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of the Internal Revenue Code.

Sec. 29.22(a)-20. *Gross Income of Corporation in Liquidation.*— * * * No gain or loss is

realized by a corporation from the mere distribution of its assets in kind in partial or complete liquidation, however they may have appreciated or depreciated in value since their acquisition. * * *

STATEMENT

The material facts as found by the Court of Claims (R. 23-30) may be summarized as follows:

The taxpayer, a Delaware corporation, with its principal office in Houston, Texas, was organized on December 31, 1929. Its original capitalization consisted of $25,842,375 of first preferred stock and $100,000 in common stock. The common stock, consisting of 100,000 shares with a stated value of $1 per share, was issued to its chief managing officials, 44,800 being issued to W. L. Clayton, 31,000 to M. D. Anderson, and the remainder, in varying amounts, to ten other managing officials. This distribution was intended to reward and retain competent management, an objective which was deemed by the taxpayer of primary importance to the success of its cotton merchandising business. (R. 23-24.)

From the beginning, it was understood by the holders of the common, all of whom were active in the business, that the stock could not be sold to persons other than the managing executives, and that even within that group disposition was to be made according to their respective responsibilities and contributions to management, as determined by the holders of at least seventy-five per cent of the common stock. It was further under-

stood that no stockholder was entitled to sell his stock, or to keep it, except as directed by the holders of at least seventy-five percent of the common stock, and that the respective interests of the holders of the common stock would be adjusted among the managerial group as responsibilities changed. (R. 24.)

In 1931, these restrictions upon the holding and disposition of the common stock were embodied in a written agreement between the taxpayer and all the common stockholders. The agreement required the holders to endorse their stock to Anderson, as trustee, for a period of ten years, but they retained the right to vote their stock, and to receive dividends. The agreement provided that upon the death of any common stockholder, the taxpayer would purchase his stock at the book value as of the preceding July 31, adjusted to reflect appreciation or depreciation of the corporate assets. Any common stockholder could elect, or upon request of the holders of seventy-five percent of the stock was required, to sell his stock to the taxpayer, and in the absence of an agreement as to price the adjusted book value figure applicable in the case of death was to be used as the price. Any stock purchased by the taxpayer could be sold to the remaining stockholders, or to any other person designated by the holders of seventy-five percent of the stock. (R. 24-26.) The agreement was extended in 1943 with modifications which are not material here (R. 28).

From time to time, as junior officials assumed

more responsibilities and duties, common stock was transferred to them by Clayton and Anderson so that upon his death in 1939 Anderson held only 18,574 shares of the 31,000 originally issued to him. On December 15, 1939, the taxpayer purchased those 18,574 shares from his estate at $50.79 per share, its valuation under the contract. During its fiscal year ending July 31, 1944 (the taxable year involved), the taxpayer sold to five of its officials at $112.68 per share, 6,500 of the 18,574 shares which it had acquired from the Anderson estate. No part of the $402,285 difference between the total sales price of $732,420 and the amount of $330,135 which it had paid to the Anderson estate for the 6,500 shares was reported by the taxpayer for income tax purposes.[1] (R. 26-28.)

The common stock bought from time to time from shareholders was not cancelled or retired, but was held in taxpayer's treasury.[2] The treasury stock was not voted at meetings of stockholders; nor taken into account in the payment of dividends or in arriving at book value under the agreement, nor was it reflected as outstanding in taxpayer's financial statements. During the taxable year, the taxpayer had no authorized, unissued capital stock. (R. 29.)

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[1] On its books, taxpayer credited the difference to an account called "Capital Surplus." See Finding 14, R. 27; cf. Finding 23, R. 28.

[2] Between 1932 and 1943, taxpayer on fifteen occasions purchased shares of its own common stock or sold shares held in its Treasury. (See Ex. No. 2, R. 43.)

The purchase of the 18,574 shares from the Anderson estate in 1939 was in conformity with the plan that the shares be resold to active management officials. The resale of the 6,500 shares during the taxable year was to adjust the respective holdings of the taxpayer's officials in accordance with responsibility, and to reward managerial performance. (R. 29-30.)[3]

The Commissioner of Internal Revenue determined that the taxpayer during the taxable year realized a long-term capital gain in the amount of $402,285, the difference between the purchase and resale price of the 6,500 shares in question, on which the tax was $100,571.25, and (with adjustments not here material) arrived at a deficiency of $89,337.66, which was paid by the taxpayer. (R. 30.) After rejection of its claim for refund (R. 30), the taxpayer instituted the present action. The Court of Claims, holding that the gain was not taxable under Section 22(a) of the Internal Revenue Code of 1939 and the applicable Treasury Regulations, rendered judgment in taxpayer's favor (R. 15-23, 30). A timely motion for rehearing or for a new trial was filed by the United States

[3] The Court of Claims also included in its findings of fact (Nos. 28 and 29, R. 29-30) statements to the effect that taxpayer was not dealing in its stock as it might in the stock of another corporation, but those statements are in our view conclusions phrased in the words of the applicable Regulations (Sec. 29.22(a)-15 of Treasury Regulations 111, *supra*). The statement by the Court in Finding 27 (R. 29), to the effect that taxpayer's purchases and sales were nothing more than withdrawals and contributions by the stockholders of its accumulated earnings, is likewise a conclusion.

and was denied by the Court without opinion (R. 30-31).

SUMMARY OF ARGUMENT

In holding that the taxpayer corporation realized no taxable gain from the purchase and resale of its "treasury stock", the court below failed to apply Section 22(a) of the Internal Revenue Code of 1939 and misconstrued the implementing Treasury Regulations. Its decision is squarely contrary to those of every Court of Appeals which has passed upon the question, as well as to the latest decision of the Tax Court.

Section 22(a), *supra*, p. 2, comprehensively defines gross income as including gains "derived from any source whatever," and this Court has repeatedly held that Congress intended in that section to embrace every kind of constitutionally taxable income. In this case, taxpayer admittedly purchased its own shares from the estate of a deceased stockholder-executive with a view to reselling them to other executives, held them in its treasury pending their resale, and did resell them at a price exceeding their cost. As a result taxpayer realized a cash addition to its net worth, amounting to the difference between the cost and selling price of the shares. This increase represents an economic gain falling within the scope of Section 22(a). There is no provision in the 1939 Code which exempts the gain from tax.

The applicable Treasury Regulations, *supra*, pp. 3-4, do not warrant the view, upon which the decision below rests, that purchases and sales of

treasury stock by a corporation must be treated as tax-free readjustments of its capital. The Regulations expressly recognize that no taxable gain or deductible loss is realized by a corporation upon an original issuance of its shares, or upon a redemption of its shares in partial liquidation; such transactions truly represent permanent readjustments of the corporation's capital, the former an increase and the latter a decrease of its outstanding capital stock. However, in harmony with Section 22(a), the Regulations also explicitly provide that "if a corporation deals in its own shares as it might in the shares of another corporation," the resulting gain or loss must be taken into account in computing the corporation's taxable income. Thus the basic test of taxability or deductibility under the Regulations is whether the corporation is revising its capital structure or simply dealing in its shares. A corporation which purchases some of its shares not for retirement but for resale, and does resell them, is not successively undergoing a downward and upward capital adjustment. On the contrary, it "deals" in its own shares as it "might" in those of any other corporation, or indeed in any other property, within the purview of the Regulations. And if so deals in them whether the shares are bought and resold in the open market or pursuant to a private contract, whether they are resold to strangers or to persons already affiliated with the corporation, and whether the transaction was designed to profit

the corporation or the selling stockholder or the purchasing stockholder or all three.

Under no tenable theory may the instant purchase-resale transaction be broken down into two separate and unrelated adjustments of taxpayer's capital. When the transaction is viewed as a whole, as it must be, and in the light of the program of similar purchases and resales of which it was a part, it is clear that the sole purpose and net effect of the transaction was a change in the identity of taxpayer's stockholders rather than a change in its capital structure. Indeed, since the purchased shares were never retired but were retained in taxpayer's treasury and resold, and since both the puchase and resale were made pursuant to a pre-arranged plan embodied in a contract between taxpayer and its stockholders, the conclusion is inescapable that the purchase and resale were interrelated steps in a single transaction effectuating a shift in ownership of the stock—not successive revisions of the corporation's capital.

The court below recognized that corporate gains from sales of treasury shares are taxable if the shares are reacquired for investment. But it interpreted the Regulations as exempting such gains from tax if the corporation contractually obligates itself to buy the shares from, or resell them to, a selected class of persons—employees—or if its dominant motive is to compensate the employees rather than to make a profit. However, a gain is not any the less taxable to the recipient because derived from the performance of a contract.

or because other parties to the contract may also benefit. Nor is the corporation any the less dealing in its shares because the purchases or resales are restricted to a particular group, such as officers or employees. The crucial inquiry is whether the shares are purchased for retirement or for resale, not why or to whom the shares are resold. Had taxpayer bought and resold its shares on a stock exchange, there could be no doubt of the taxability of the resulting gain. That the shares were bought and resold directly between taxpayer and its stockholder-employees pursuant to a contract does not insulate it from tax liability. In a long line of cases involving the same question as is here presented, the Courts of Appeals have uniformly held the gains to be taxable and in so doing have properly dismissed as immaterial the factors deemed controlling by the court below. The most recent of these are *Commissioner* v. *Landers Corp.*, 219 F. 2d 188 (C. A. 6); *Commissioner* v. *H. W. Porter & Co.*, 187 F. 2d 939 (C. A. 3); *Commissioner* v. *Rollins Burdick Hunter Co.*, 174 F. 2d 698 (C. A. 7); *Commissioner* v. *Batten, Barton, Durstine & Osborn*, 171 F. 2d 474 (C. A. 2). Even the Tax Court, with whose prior decisions the court below expressed agreement, has since changed its position and now follows the holdings of the Courts of Appeals. *Farmers Mills* v. *Commissioner*, 22 T. C. 881.

The court below argued that no tax is involved in the retirement and reissue of stock and that to differentiate the sale of treasury stock would emphasize form over substance. This overlooks the

fact that there are materially different legal consequences involved in the two types of transactions. Moreover, if the retirement and reissue were merely a disguise for a preconceived purchase and sale, it is at least doubtful that the taxpayer could escape the tax consequences which would have been imposed. In any event, there is no need here to determine what the tax result would have been if the taxpayer had followed another course, for the undisputed fact remains that it did not do so; but for reasons of its own chose to treat the purchased shares as treasury stock and to resell them. Its tax liability stems from what it did, not from what it might have done.

The error of the court below is accentuated by its reliance upon *Eisner* v. *Macomber*, 252 U. S. 189. The question there involved—taxability of a stock dividend to the stockholder—is far removed from that here presented. Moreover, as this Court recently held in *Commissioner* v. *Glenshaw Glass Co.*, 348 U. S. 426, the *Macomber* decision was not meant to curtail the applicability of Section 22(a) in other situations. The gain here in question, like that involved in the *Glenshaw Glass Co.* case, constitutes an accretion to taxpayer's wealth falling clearly within the Section 22(a) definition of gross income.

Had Congress intended to except gains from sales of treasury shares from the sweeping coverage of Section 22(a) and, conversely, to disallow deductions of losses from such sales, it could readily have done so. It has done so in the Internal Reve-

nue Code of 1954, applicable to years after 1953. Congress created no such exception for years to which the 1939 Code applies.

ARGUMENT

The Gain Realized by Taxpayer from the Sale of Its Treasury Shares Is Includible in Its Gross Income Under Section 22(a) of the Internal Revenue Code of 1939 and the Applicable Treasury Regulations

Section 22(a) of the Internal Revenue Code of 1939[4] (*supra*, p. 2) comprehensively defines gross income as including "gains, profits, and income derived from * * * dealings in property * * * or gains or profits and income derived from any source whatever." The implementing Treasury Regulations (Section 29.22(a)-15 of Regulations 111 under the Code, *supra*, p. 3) provide in part that whether the acquisition or disposition by a corporation of its own shares gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, and that—

> if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another.

The question in this case is whether the difference between the amount paid by the taxpayer corporation to purchase shares of its own stock and the higher amount received upon their resale con-

[4] Unless otherwise noted, references to the Code are to the Internal Revenue Code of 1939.

stituted taxable income to it. The answer depends on whether taxpayer dealt in its own shares, within the purview of the Treasury Regulations, by purchasing them for resale, holding them as treasury stock pending their resale, and reselling them.

The material facts are not in dispute. All of taxpayer's common stock was originally issued to its executives (R. 23). Shortly after its organization the corporation entered into a written agreement with the stockholder-executives restricting ownership of the common stock to managing officials. The agreement provided that none of the stockholders would transfer his shares without the written consent of holders of seventy-five percent of the stock; that upon the death of a stockholder the corporation would purchase his shares at book value based upon the current net worth of the corporation; that at any time any stockholder could elect, or the holders of seventy-five percent of the stock could require him, to sell his shares to the corporation at the book value; and that shares purchased by the corporation could be resold to the remaining stockholders, or to any other person, on such terms as might be agreed upon by the corporation and the holders of seventy-five percent of the remaining shares. (R. 24-26, 44-51.) Pursuant to the agreement, taxpayer on a number of occasions between 1932 and 1943 purchased shares of its stock, placed them in its treasury, and resold them, the purchase and resale prices varying as the book valuation of the shares varied (R. 43, 79). Among such transactions was the purchase and re-

sale of the shares of one of taxpayer's chief stockholder-executives, Anderson. Upon Anderson's death in 1939 taxpayer purchased his shares from his estate at their then agreed book value of $50.79 per share, held them as treasury stock, and during the taxable year (fiscal year 1944) resold 6,500 of these shares to five stockholder-executives at the book value of $112.68 per share. (R. 26-27, 50-51, 77-79, 83.) The $402,285 difference between the total price paid for these shares ($330,135) and the total price received upon their resale ($732,420) was credited by taxpayer to its capital surplus account, but was not reported for income tax purposes. (R. 27, 38.) The Commissioner determined that the difference was taxable as long-term capital gain. (R. 30.)

The Court of Claims, disagreeing with all of the Courts of Appeals which have passed upon the question here presented,[5] as well as with the current view of the Tax Court,[6] held that no taxable

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[5] The decisions of the Courts of Appeals are listed and discussed *infra*, pp. 29 to 32.

[6] *Burrus Mills* v. *Commissioner*, 22 T.C. 881, decided the day after the decision below was filed. See also, *M. Conley Co.* v. *Commissioner*, 6 T.C. 250; *Superheater Co.* v. *Commissioner*, decided March 17, 1943 (1943 P-H T.C. Memorandum Decisions, par. 43,129); *Brown Shoe Co.* v. *Commissioner*, 45 B.T.A. 212; and *Pittsburgh Laundry* v. *Commissioner*, 43 B.T.A. 230.

The decision of the Court of Claims in the instant case is also inconsistent with its own prior decision in *Edwin L. Wiegand Co.* v. *United States*, 60 F. Supp. 464. While the court stated that this case was "distinguishable on its facts" (R. 22), we are unable to find any factual differences which warrant a difference in result.

gain was realized by taxpayer from the purchase and resale of the shares. Although at one point in its opinion the court below professed to approach the question as one of fact (R. 22-23), it is plain from the opinion as a whole that its decision rests upon what it conceived to be a proper interpretation of Section 22(a) and the applicable Treasury Regulations. This case is not factually different in any material respect from those involving the same question and decided differently by the Courts of Appeals, and the court below made no attempt to distinguish this case from any of those decided by the Courts of Appeals. It simply and flatly disagreed with the principles which those courts considered controlling, and applied entirely different legal criteria and standards of its own. Since the case turns upon a correct construction of the taxing statute and the Regulations, and the court below laid down rules of general applicability, its decision is reviewable as a question of law. *Bingham's Trust* v. *Commissioner*, 325 U.S. 365, 371; *Commissioner* v. *Rollins Burdick Hunter Co.*, 174 F. 2d 698, 702 (C.A.7); *Commissioner* v. *Batten, Barton, Durstine & Osborn*, 171 F. 2d 474, 477 (C.A. 2).

The disagreement with prior decisions stems chiefly from differing interpretations of the applicable Treasury Regulations, the court below construing the Regulations as rendering taxability of the gain dependent upon the taxpayer's reasons for buying and reselling its shares, whereas the Courts of Appeals regard motives and similar factors as immaterial. The court below not only

rejected the holdings of the Courts of Appeals insofar as taxability of the gain is concerned; it questioned the existence of a gain even though the taxpayer resold the shares for more than it paid for them. It is the Government's position that the long and unbroken line of decisions of the Courts of Appeals, rather than the contrary decision of the court below, represents the correct view.

A. *Taxpayer realized gain from the purchase and resale of its shares.*

No extended argument is needed to demonstrate that taxpayer realized a gain from the purchase and resale of the 6,500 shares in question. It paid $330,135 in cash to acquire the shares, and it received $732,420 in cash upon their resale,[7] thereby increasing its assets and net worth by the difference of $402,285. The difference between the cost and resale price of the shares represented economic gain in every sense of the term. Taxpayer "realized within the year an accession to income, if we take words in their plain popular meaning, as they should be * * *." *United States* v. *Kirby Lumber Co.*, 284 U.S. 1, 3. See also *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426; *General American Investors Co.* v. *Commissioner*, 348 U.S. 434; *Helvering* v. *Bruun*, 309 U.S. 461; *Helvering* v. *American Chicle Co.*, 291 U.S. 426; *Merchants' L. & T. Co.* v. *Smietanka*, 255 U.S. 509.

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[7] Taxpayer received notes for the resale price, but it is stipulated that their amount may be treated as cash for purposes of this case. (R. 26.)

In the *Kirby* case this Court held that a corporation which purchased its own bonds for less than their face amount realized taxable income in the amount of the difference, since its net worth was increased by that amount. A corporation which sells treasury shares at a price greater than cost likewise enhances its net worth in the amount of the difference. As was said in *Commissioner* v. *H. W. Porter & Co.*, 187 F. 2d 939, 941 (C.A. 3d), involving the very question here presented, the excess of the amount received over the amount paid for the shares "certainly looks like gain to a man in the street, whatever accountants might say about it." See also *Commissioner* v. *Landers Corp.*, 240 F. 2d 188, 191 (C.A. 9th); *Helvering* v. *Edison Bros. Stores*, 133 F. 2d 575, 579 (C.A. 8th), certiorari denied, 319 U.S. 752.

Although the court below specifically disclaimed that its decision was based on the theory that there can be no gain from the purchase and sale of treasury stock (R. 20), it does reiterate doubts, referring to *E. R. Squibb & Sons* v. *Helvering*, 98 F. 2d 69 (C.A. 2), that gain or loss can result when the transactions are priced on the basis of the value of the stock's proportionate share of the corporate assets. In part this doubt seems to stem from the accounting treatment customarily accorded dealings in treasury stock, i.e., no gain or loss is recorded on the profit and loss statement and the treasury stock, while held, is not

carried as an asset on the balance sheet.[8] But this has no bearing on whether from the tax viewpoint the corporation has realized a gain.[9] From an accounting standpoint, it would be confusing, and often misleading, to integrate the dealings of a corporation in its stock with its business functions. But this feature is not decisive, nor even significant, where the question is whether there was gain or profit "from any source whatever."

However, the court below questions whether there can be a gain when both purchases and sales are made at prices fixed by the value of the corporate assets attributable to the stock bought and sold. It is suggested that in each case the corporation paid or received the equivalent of the value of the stock. The error in this reasoning lies in treating the purchases and sales as isolated transactions. Actually the stock was bought at one price, was held during a period while it increased in value, and was sold at a price reflect-

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[8] Finney and Miller, *Principles of Accounting, Intermediate* (5th ed. 1953), 235-237, 284-291; Paton, *Accountants' Handbook* (3rd ed.) 1006-1014; Securities and Exchange Commission, Accounting Series, Release No. 6 (1938).

[9] The manner in which taxpayer recorded the transaction on its books is not, of course, determinative of whether gain was realized, or of taxability of the gain. *Bazley* v. *Commissioner*, 331 U.S. 737, 741; *Helvering* v. *Midland Ins. Co.*, 300 U.S. 216, 225; *Weiss* v. *Wiener*, 279 U.S. 333, 335; *Old Colony R. Co.* v. *Commissioner*, 284 U.S. 552, 562. As a matter of fact, taxpayer on its books credited the excess of the selling price over the cost of the treasury shares to its "capital surplus" account. (Finding 14, R. 27; R. 36-37; see also Findings 22-24, R. 28-29.)

ing the increase. This is gain to the corporation—a taxable entity apart from its stockholders[10]—just as truly as where any other property is sold at an appreciated value.

The court below also reasoned that the difference between the purchase and resale prices "represents largely, if not entirely, accumulated earnings of the corporation which have already been subjected to tax," and that consequently "it is rather difficult to comprehend how plaintiff corporation realized an accession to income." (R. 22.)[11] A simple illustration shows the fallacy of this reasoning. Suppose A, B and C form Corporation X, each contributing $1,000 for 10 shares of stock. After X has earned $300 (bringing its net worth to $3,300) it purchases A's shares for their proportionate value of $1,100 and holds them as treasury stock. X then has a net worth of $2,200 and B and C each own stock worth $1,100. X earns an additional $200 bringing its worth to $2,400. It resells the treasury shares to D at their proportionate value of $1,200. The end result is that the corporation's net worth has increased by $600 (from $3,000 to $3,600) comprised of $500 of

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[10] *Moline Properties v. Commissioner*, 319 U.S. 436; *National Carbide Corp. v. Commissioner*, 336 U.S. 422.

[11] There is no reason to suppose that all or even most of the increase in taxpayer's net worth between the purchase and resale dates reflected additional retained earnings, rather than an unrealized increment in the value of the corporate assets; and nothing in taxpayer's earned surplus account (R. 84-85) or elsewhere in the record justifies the inference. On the contrary, taxpayer's surplus account shows an entry, as of July 31, 1943, of over $7,000,000 as "appreciation" in stocks of subsidiaries. (R. 80.)

undistributed earnings plus $100 gain from the purchase and sale of the treasury stock. Although the increase in price resulted from the retention of corporate earnings, the added $100 came from D's pocketbook, not from the earnings of the taxpayer.

B. *The gain constitutes taxable income*

The gain realized by taxpayer—the difference between the purchase and resale price of the shares—is not immune from tax. It comes within the definition of gross income contained in Code Section 22(a), and the Court of Claims erred in holding that the Treasury Regulations place it beyond the reach of that section.

1. *The gain falls within Section 22(a)*

The gain unquestionably falls within the broad scope of Section 22(a), which defines gross income as including gains "derived from any source whatever." This sweeping language evinces a congressional intent to tax all kinds and forms of constitutionally taxable income, except those items explicitly excluded elsewhere in the statute. *Commissioner* v. *Glenshaw Glass Co.*, *supra*; *General American Investors Co.* v. *Commissioner*, *supra*; *Helvering* v. *Bruun*, *supra*; *Commissioner* v. *Jacobson*, 336 U.S. 28, 49; *Helvering* v. *Clifford*, 309 U.S. 331, 334; *Douglas* v. *Willcuts*, 296 U.S. 1, 9; *Irwin* v. *Gavit*, 268 U.S. 161, 166. As was only

recently said in the *Glenshaw* case, *supra* (pp. 429-430):

> This Court has frequently stated that this language was used by Congress to exert in this field "the full measure of its taxing power." * * * Congress applied no limitations as to the source of taxable receipts, nor restrictive labels as to their nature. And the Court has given a liberal construction to this broad phraseology in recognition of the intention of Congress to tax all gains except those specifically exempted.

There is no provision in the Code which even remotely suggests that Congress intended to exempt corporate gains derived from sales of treasury stock from the all-embracive coverage of Section 22(a). Nor has the court below pointed to any such provision.[12]

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[12] For years after 1953, Section 1032 of the Internal Revenue Code of 1954 removes gains or losses from sales of treasury stock from the area of taxable gains and deductible losses, by specifically providing that "No gain or loss shall be recognized to a corporation on the receipt of money or other property in exchange for stock (including treasury stock) of such corporation." No comparable provision appears in the 1939 Code. The committee reports accompanying the 1954 Code state, with reference to Section 1032, that its purpose was "to remove the uncertainties of present law." H. Rep. No. 1337, 83d Cong., 2d Session, p. A268; S. Rep. No. 1622, 83d Cong., 2d Sess., p. [illegible]. The only uncertainty in the law at the time of those reports stemmed from a difference of opinion between the Tax Court and the Courts of Appeals as to the proper interpretation of the pertinent Treasury Regulations — a difference which has since disappeared. See *Burrus Mills v. Commissioner*, 22 T.C. 881.

2. The Treasury Regulations do not exempt the gain from tax.

Although the taxing statute itself contains no provision according tax exemption to gains from sales of treasury stock, the Court of Claims purported to find a basis for exemption in the Treasury Regulations addressed to Section 22(a). It construed the Regulations as subjecting such gains to tax only if the corporation purchased its shares "as an investment" and resold them "at opportune times" (R. 20), but as exempting the gains from tax if the corporation acting without a profit motive contractually "obligated" itself in advance to purchase the shares and resell them to a particular class of persons, such as employees (R. 21-22).[13]

[13] Even under the court's own narrow interpretation of the Regulations, the gain in question would appear to be taxable. The contract between taxpayer and its stockholders required taxpayer to buy shares only upon the death or the election of a stockholder; and it did not require it to sell any shares at any time. The contract *authorized* holders of seventy-five percent of the stock to require taxpayer to buy shares at any time from any stockholder, and to resell shares at any time to any remaining stockholder or other person (R. 24-26, 44-48), thus permitting taxpayer to buy and resell its shares for such purposes and at such times as the holders of seventy-five percent of the stock saw fit. Nothing in the contract obligated taxpayer to resell during the taxable year or at any other time the 6,500 shares in question which it bought from the Anderson estate and was holding in its treasury. The shares were resold during the taxable year (to remaining stockholders) only because holders of seventy-five percent of the stock chose at that time to direct taxpayer to do so. (R. 50-51.) Moreover, taxpayer's alleged obligation to buy and sell its shares was created by

We need not stop to consider whether, if the Regulations are susceptible of only the narrow construction placed upon them by the court below, they might be deemed invalid because inconsistent with the plain legislative intent expressed in Section 22(a). Cf. *Manhattan Co.* v. *Commissioner*, 297 U.S. 129; *Commissioner* v. *Landers Corp.*, 210 F. 2d 188, 191 (C.A. 6th).[14] For no such interpretation is demanded, or even justified, by the terms of the Regulations. Far from restricting the scope of Section 22(a), the applicable Treasury Regulations implement its purpose by requiring inclusion in the gross income of a corporation of any gain derived from a purchase and resale of treasury shares, regardless of whether the transaction takes place pursuant to a contract, or of whether the purchasing and selling stockholders are also employees of the corporation, or of whether the motive underlying the transaction is to profit the corporation or the stockholder-employees or both.

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agreement between it and its controlling stockholders, and could be changed or terminated at the latters' will. (R. 26.) Accordingly, even assuming, as the court below held, that the Regulations are to be construed as covering only situations in which a corporation is free to buy or sell its shares at opportune times, the instant arrangement would not place the gain in question beyond the pale of the Regulations.

[14] In *Helvering* v. *Reynolds Co.*, 306 U.S. 110, it was held that the Regulations in force prior to 1934, expressly providing that a corporation realizes no gain or loss from the purchase or sale of its own stock, had received implied congressional approval by virtue of repeated re-enactments of Section 22(a).

Section 29.22(a)-15 of Treasury Regulations 111, *supra*, p. 3, provides in part that "the receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss," whether the issue price is lower or less than the par or stated value of the stock. Section 29.22(a)-20 of the same Regulations, *supra*, pp. 3-4, provides in part that "No gain or loss is realized by a corporation from the mere distribution of its assets in kind in partial or complete liquidation," i.e., upon a redemption of its shares,[15] whether the assets have appreciated or depreciated in value since their acquisition. However, Section 29.22(a)-15 further provides that "if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another."[16] These Regula-

[15] Under Code section 115(c) distributions in complete or partial liquidation are treated as payments in exchange for the stock. Section 115(i) defines a partial liquidation as "a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock."

[16] The same section of the Regulations also requires recognition of gain or loss if a corporation receives its own stock in payment of property sold by it, or in satisfaction of indebtedness to it. *See Commissioner* v. *S. A. Woods Mach. Co.*, 57 F. 2d 635 (C.A. 1st certiorari denied, 287 U.S. 613; *Commissioner* v. *Boca Ceiga Development Co.*, 66 F. 2d 1004 (C.A. 3d); *Trinity Corp.* v. *Commissioner*, 127 F. 2d 604 (C.A. 5th), certiorari denied, 317 U.S. 651. This portion of the Regulations is not directly involved here.

tions are long-standing [17] and under familiar rules must be deemed to have received implied legislative approval by virtue of successive reenactments of Section 22(a), the statutory provision to which they are addressed. *Helvering* v. *Winmill*, 305 U. S. 79, 82-83; *Helvering* v. *Reynolds Co.*, 306 U. S. 110; *Commissioner* v. *Flowers*, 326 U. S. 465, 469; *Lykes* v. *United States*, 343 U.S. 118, 127. Every court passing upon the taxability of corporate gains from sales of treasury stock has upheld the validity of the Regulations, in a variety of circumstances and over a period of almost two decades. See, e.g., *Commissioner* v. *H. W. Porter & Co.*, *supra*, p. 940; *Commissioner* v. *Landers Corp.*, *supra*, p. 191; *Commissioner* v. *Rollins Bardick Hunter Co.*, 174 F. 2d 698 (C.A. 7th). And the court below likewise assumed their validity, resting its decision on what it conceived to be a proper construction of the Regulations. (R. 20-22.)

When the above provisions of the Regulations are read in conjunction with each other, it is clear that a corporation does not realize a taxable gain or deductible loss by (1) issuing new stock in exchange for capital needed in its business, or (2) redeeming outstanding stock in exchange for capital no longer needed in the business. Either of such transactions, standing by itself, constitutes a nontaxable readjustment of the corporation's capital. In the former case—an original issue of

[17] Provisions corresponding to Section 29.22(a)-15 of Regulations 111 appeared in the Regulations issued under all revenue acts since the 1934 Act. Provisions corresponding to Section 29.22(a)-20 of Regulations 111 appeared in the Regulations issued under all revenue acts since the 1918 Act.

stock—the corporation is merely obtaining the capital with which to commence or expand its business; in the latter case—reacquisition of the stock in partial or complete liquidation—it is merely returning the capital upon a contraction or termination of the business.

On the other hand, it is equally plain from the Regulations that if the corporation reacquires some of its shares, holds them in its treasury, and resells them, then the reacquisition and resale of the shares may not be viewed as separate and unrelated readjustments of the corporation's capital. In such a case the corporation patently does not reacquire its shares in order to decrease its capital, nor does it issue new shares in order to increase its capital. On the contrary, by placing the reacquired shares in its treasury and reselling them the corporation "deals in its own shares as it might in the shares of another corporation," within the purview of the Regulations, and the difference between the purchase and resale price must be reflected in a computation of the corporation's taxable income just as if the corporation were buying and selling any other property. If any doubt otherwise existed as to the purpose and meaning of the pertinent Regulations, it is dispelled by the history of Section 29.22(a)-15 of Regulations 111, which shows that it was designed to change and supplant preexisting Regulations denying recognition to gains or losses from dealings by a corporation in its own shares.[18]

[18] Originally, the Regulations provided that gain from the sale of treasury stock was taxable. Article 98 of Regulations 33 (Rev.) under the Revenue Act of 1916, as amended by the

In short, under the Regulations the crucial inquiry is whether the transaction, viewed from beginning to end, is a readjustment of the corporation's capital or a dealing in its shares, and the answer depends upon whether the reacquired shares are retired or resold. It is one thing for a going corporation to reacquire some of its stock in contraction of its business, or to issue new stock in expansion of its business. The applicable Treasury

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Revenue Act of 1917. Thereafter, until 1934, the Regulations provided that no gain or loss is realized if a corporation purchases or sells its own stock. Article 542 of Regulations 45 (1918 Act); Article 543 of Regulations 62, 65, and 69 (1921, 1924, and 1926 Acts); Article 66, Regulations 74 and 77 (1928 and 1932 Acts). In 1934 the Regulations were again changed so as to recognize such gains or losses, and thereafter they remained the same under all subsequent Revenue Acts and under the Internal Revenue Code of 1939. Article 22(a)-16 of Regulations 86, 94 and 101 (1934, 1936, and 1938 Acts); Section 19.22(a)-16 of Regulations 103 and Section 29.22 (a)-15 of Regulations 111 under the Code. See also G.C.M. 16651, XV-2 Cum. Bull. 130 (1936). The 1934 change stemmed from decisions at variance with the Regulations previously in force. See *Commissioner* v. *S. A. Woods Mach. Co.*, *supra*; *Commissioner* v. *Air Reduction Co.*, 130 F. 2d 145 (C.A. 2d), certiorari denied, 317 U.S. 681; *Commissioner* v. *Rollins Burdick Hunter Co.*, 174 F. 2d 698 (C.A. 7th). As pointed out in the *Rollins* case (pp. 699-700), the Regulations as amended in 1934 followed the language of the opinion in the *Woods* case.

The Commissioner's attempt to make the 1934 change retroactive (T.D. 4430, XIII-1 Cum. Bull. 36 (1934)) was held invalid, on the ground that the prior Regulations had acquired the force of the law. *Helvering* v. *Reynolds Co.*, 306 U.S. 110. However, this did not preclude prospective application of the amended Regulations (*Helvering* v. *Wilshire Oil Co.*, 308 U.S. 90; *Helvering* v. *Reynolds*, 313 U.S. 428), and, as the court below noted (R. 19-20), their applicability to post-1934 transactions has been uniformly sustained.

Regulations expressly recognize that neither of such transactions *per se* gives rise to taxable gain or deductible loss to the corporation. But it is quite another matter for the corporation to reacquire its own shares with a view to reselling them, retain them as treasury stock, and then resell them. A corporation engaging in the latter type of transaction manifestly has no intention permanently to reduce its capital, but "deals" in its shares as it "might" in those of another corporation or in any other property; and the Regulations are equally explicit in requiring tax recognition of gains or losses resulting from such transactions.

The Courts of Appeals in a long line of carefully considered opinions have uniformly held that a corporation which reacquires its own shares, holds them in its treasury, and later resells them at a price greater than cost, realizes a taxable gain under Section 22(a) and the applicable Regulations.[19] The gain has been held taxable notwithstanding the fact that the corporation had no profit motive, and that it contractually obligated itself in advance to reacquire the shares and reissue them to particular individuals or groups of individuals (e.g., employees) at previously fixed prices. *Commissioner* v. *Landers Corp.*, 210 F. 2d 188 (C.A. 6th); *Commissioner* v. *H. W. Porter & Co.*, 187 F. 2d 939 (C.A. 3d); *Commissioner* v. *Rollins Burdick Hunter Co.*, 174 F. 2d 698 (C.A. 7th); *Commissioner* v. *Batten, Barton, Durstine & Osborn*, 171 F. 2d 474 (C.A.

[19] As previously noted, the Tax Court now agrees with the Courts of Appeals. *Burrus Mills* v. *Commissioner*, *supra*.

2d), certiorari denied, 338 U.S. 816; *Aviation Capital v. Pedrick*, 148 F. 2d 165 (C.A. 2d), certiorari denied, 326 U.S. 723; *Dow Chemical Co. v. Kavanagh*, 139 F. 2d 42 (C.A. 6th); *United States v. Stern Bros. & Co.*, 136 F. 2d 488 (C.A. 8th); *Brown Shoe Co. v. Commissioner*, 133 F. 2d 582 (C.A. 8th); *Helvering v. Edison Bros. Stores*, 133 F. 2d 575 (C.A. 8th), certiorari denied, 319 U.S. 752; *Commissioner v. Air Reduction Co.*, 130 F. 2d 145 (C.A. 2d), certiorari denied, 317 U. S. 681; *Allen v. National Manufacture & Stores Corp.*, 125 F. 2d 239 (C.A. 5th), certiorari denied, 316 U.S. 679; cf. *Commissioner v. S. A. Woods Mach. Co.*, 57 F. 2d 635 (C.A. 1st), certiorari denied, 287 U.S. 613. As was pointed out in the *Landers* case, *supra*, all of the Courts of Appeals (p. 491)—

> have construed the Regulations as meaning that regardless of the original purpose of the corporation in purchasing its shares, if the corporation does not actually cancel and retire the shares so purchased but later sells them, regardless to whom they are sold, the corporation has sold an asset in the same way as when it sells the shares of another corporation which it might own, and that any resulting gain is the same type of taxable income as would result from a profit derived from the sale of any other asset.

Essentially, the rationale of the decision is that the purchase and resale of treasury stock do not constitute successive downward and upward ad-

justments of the corporation's capital, but in substance and effect are interrelated component steps in a buying-selling transaction, the resulting gain from which constitutes taxable income under Section 22(a) and the applicable Regulations. As was said in the *Porter* case, *supra*, pp. 941-942, which involved substantially the same situation as is here presented:

> But the problem is not a new one. Every court passing upon the Regulation has upheld it, in a variety of circumstances and over a period of some ten years. The courts have uniformly upheld the taxation of the gain from the sale of treasury stock under it. At this late date we do not feel constrained to disagree. We share the conclusion that the regulation is a valid interpretation of Section 22(a) of the Internal Revenue Code, 26 U.S.C.A. § 22(a) and that it permits the taxation as gain to a corporation of the difference between the purchase price and the selling price of its treasury shares.
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> * * * * * *
>
> The Commissioner takes the position that whenever a corporation reacquires its own shares, for the purpose of reselling them, holds them in its treasury instead of retiring them and later does sell them, it is dealing in its shares as in the shares of another and thus comes within the Regulation. He says that so

> long as there is no readjustment in capital structure the economic gain or loss to the corporation is the same regardless of the motive of the corporation in dealing in its own stock.
>
> We agree with the Commissioner. * * * The emphasis has been on the final result from the buying and selling and not on motive. The determining factor has not been whether the purpose of the dealings could have been achieved by dealing in the stock of another corporation, but whether the transaction resulted in a "capital adjustment."

The court below in effect treated the purchase and resale of the shares in question as two separate and independent transactions, each constituting an adjustment of taxpayer's capital. It regarded the purchase as though it were a retirement of stock in partial liquidation of the business, and the resale as though it were an original issuance of new shares for new capital. But when the transaction is viewed in its entirety, as it must be (cf. *Commissioner* v. *Court Holding Co.*, 324 U.S. 331; *Arrowsmith* v. *Commissioner*, 344 U.S. 6), the conclusion is inescapable that what occurred was in substance and effect merely a change in the ownership of the stock—a purchase of the shares by taxpayer from one of the stockholders (the Anderson estate), and a resale of the same shares to other stockholders. There was no change in taxpayer's capital structure, either upon the purchase or the resale. The purchased shares admittedly were not retired, but

were held as treasury stock pending their resale. Nor were any new shares issued; indeed, taxpayer could not have issued new shares, since it had no authorized unissued stock. (R. 28-29.) Moreover, the purchase and resale of the shares in question were not isolated events, but were part and parcel of a purchase-resale program. As the court below found, it was taxpayer's policy from the beginning to purchase shares from outgoing executives and resell them to remaining or incoming executives (R. 24, 29), a policy which was incorporated into a written contract between the corporation and its stockholders (R. 24-26). On no less than fifteen occasions between 1932 and the taxable year, taxpayer purchased shares of its stock or sold shares held in its treasury. (R. 43.)[20] Such recurring purchases and resales of its own shares may hardly be viewed as a series of successive contractions and expansions of taxpayer's business capital. What is more, the purchases and resales bore no relationship to taxpayer's capital needs; they were made pursuant to a prearranged plan embodied in a contract, and for the avowed purpose of restricting ownership of the stock to the managing officials of the corporation. (R. 24-26.)[21]

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[20] The taxpayer was authorized to buy and sell its own shares at such prices and at such terms as its board of directors determined. (R. 54.) See also Revised Code of Delaware (1935), Section 2051.

[21] Gains from sales of treasury shares have been held taxable even though the sales were made to secure needed additional working capital. See *Aviation Capital* v. *Pedrick*, *supra*; *Allen* v. *National Manufacture & Stores Corp.*; *Commissioner*

Any one of the above features is incompatible with the notion that taxpayer's purchases and resales of its shares constituted readjustments of its capital. Viewed collectively, they demonstrate conclusively that the sole purpose and net effect of the entire transaction was to substitute one stockholder for another. Under no tenable theory may the transaction be fitted into those portions of the Regulations which treat as nontaxable events, from the corporation's viewpoint, either a reduction of stock in partial liquidation or an original issue of new stock. Rather it falls within that portion of the Regulations which requires the taxation of gains realized by a corporation from dealings in its own shares. The situation here is essentially no different from those presented in numerous other cases in which the Courts of Appeals have consistently refused to accord tax exemption to similar gains. Indeed, the instant case bears a striking resemblance to *Commissioner* v. *Rollins Burdick Hunter Co., supra.* There as here the corporation pursuant to a contract purchased its own shares from former employees, put them in its treasury, and later sold them to deserving employees at book value prices fixed by the contract. Agreeing with the decisions of other Courts of Appeals in analogous cases, the court held that the excess of the sales price over cost represented taxable gain. After reviewing the

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v. *Batten, Barton, D. & O., supra; Dow Chemical Co.* v. *Kavanagh, supra; Commissioner* v. *Landers Corp., supra. A fortiori,* they are taxable where as here no such purpose is present.

history of the applicable Regulations the court stated (p. 701):

> The capital structure of the taxpayer never changed. It was authorized to issue 1,000 shares, which it did issue and never canceled. The fact that at various times it purchased and resold some of its own shares merely resulted in a change of identity of its shareholders. Such transactions can hardly be considered a readjustment of capital structure. We are in agreement with the cases previously discussed, wherein the various circuits have held the gains from similar transactions to be taxable income. We think that a profit upon the sale by a corporation of its treasury stock under the circumstances of this case, is within the statutory definition, "gains or profits and income derived from any source whatever."

See also Commissioner v. *Landers Corp., supra; Commissioner* v. *H. W. Porter & Co., supra; Commissioner* v. *Batten, Barton, D. & O., supra; Aviation Capital* v. *Pedrick, supra; Commissioner* v. *Air Reduction Co., supra; Helvering* v. *Edison Bros. Stores, supra; United States* v. *Stern Bros. & Co., supra.*

Had taxpayer bought and resold its shares on a stock exchange, there could be no doubt whatever of the taxability of the resultant gain, even under the narrow construction placed upon the Regulations by the court below. That the purchases and resales were made directly between the corporation

and its employees, pursuant to a preconceived plan embodied in a contract with its stockholders, does not alter the true nature and tax effect of the transaction. A corporation "deals" in its own shares, within the meaning of the Regulations, no less when it contractually obligates itself to buy the shares from and resell them to its employees at previously agreed prices than when it buys from and resells to strangers in the market place. Moreover, by engaging in such activities the corporation deals in its shares as it "might" in those of another corporation, within the meaning of the Regulations, for shares of another corporation—or indeed any other property—"might" be bought and sold by a corporation in discharge of a contractual obligation to its employees or to some other selected group of persons.[22] Certainly a corporation which sold property other than its own shares would not be insulated from tax liability on the attendant gain, or be foreclosed from deducting an attendant loss, merely because the property was sold to its employees pursuant to a contract. No valid reason appears, and none is suggested by the court below, for creating a different rule with respect to gain or loss realized by a corporation from the pur-

[22] The phrase "as it might in the shares of another corporation," appearing in the Regulations, was taken from the opinion of the First Circuit Court of Appeals in *Commissioner* v. *S. A. Woods Mach. Co.*, *supra*. As was pointed out in the *Rollins* case, *supra*, p. 700, the phrase was employed in that opinion and is used by the Commissioner in the Regulations as "illustrative," and was not intended to be restrictive.

chase and resale of its own shares. The Regulations as interpreted by all of the appellate courts which have passed upon the question properly preclude the use of a different rule.[23]

In disagreeing with the uniform holdings of the Courts of Appeals the court below relied upon a mixture of several theories. We submit that none of them has merit.

1. Acknowledging that corporate gains from sales of treasury shares are taxable if the shares are purchased "as an investment" (R. 20), the court below regarded the instant gain as tax-free because the transaction was motivated by a desire to reward the employee-stockholders and provide an incentive for their efforts rather than by a desire to make a profit for the corporation itself (R. 20-21). But even granting these were the only

[23] In the language of the Court in *Helvering* v. *Edison Bros. Stores*, 133 F. 2d 575 (C.A. 8), at 581—

> The argument of the taxpayer is that the sale of its own stock to its employees, under a plan adopted by the corporation for the purpose of creating and sustaining employee interest in the affairs of the corporation, is not dealing in its own stock by the corporation as it might deal in the shares of another corporation. The point is made that the purchase and sale of the shares in another corporation could not satisfy the essential purpose of the employee purchase plan. This, of course, is true but immaterial. The material fact is that the corporation bought and sold its own stock at a profit dealing, in controlling aspects of the transaction, as it might have dealt with the stock of another corporation. The fact that these profitable sales were made to employees is not alone determinative of the character of the transaction viewed as a whole. We think the transaction clearly within the department's regulations.

motives underlying the program, the fact remains that the corporation did receive more for the shares than it paid for them and hence realized a profit from the transaction. A taxpayer obviously does not escape tax on a realized gain merely because the transaction from which it flows has a motive other than gain. The economic substance and effect of the transaction rather than the motives of the parties governs its tax significance, and the courts have properly refused to consider absence of a profit motive as a ground for exempting similar gains from tax. "Once it is accepted that there is gain or loss taxwise when a corporation buys and resells its own stock without retiring it, there appears no basis for any inquiry into motive." *Commissioner* v. *H. W. Porter & Co., supra*, p. 941. See also *Commissioner* v. *Rollins Burdick Hunter Co., supra*, p. 702; *Commissioner* v. *Landers Corp., supra*, p. 191; *Commissioner* v. *Button, Barton, D. & O., supra*, p. 476; *Aviation Capital* v. *Pedrick, supra*, p. 167; *Commissioner* v. *Air Reduction Co., supra*, p. 148. When compared to the *Landers* case, for example, the instant case is an *a fortiori* one for taxing the gain. There the corporation did not even intend to resell the shares when it purchased them but later decided to resell them to employees in order to obtain additional capital (p. 189). Here the taxpayer purchased its shares for the very purpose of reselling them to employees.

2. Equally unsound is the somewhat related theory advanced by the court below, namely, that the gain escapes tax because taxpayer contractually

"obligated" itself to purchase the shares from withdrawing stockholder-employees and to resell them to other employees at an agreed book-value figure. (R. 21-22.) Income does not cease to be taxable because it is derived from the performance of a contract. As was said in the *Rollins* case, *supra*, p. 702, "a contractual obligation to sell to employees does not remove the resulting gain from taxation." Indeed, as we previously noted, the contractual feature of the arrangement "serves to confirm the correctness of the Commissioner's position that the purpose and effect of the entire transaction was a change in the identity of taxpayer's stockholders, not a readjustment of its capital. This same feature has been relied upon by the taxpayers in other cases, and has been repeatedly rejected by the Courts of Appeals, as a ground for relieving the corporation of tax liability. See, e. g. *Commissioner* v. *H. W. Porter & Co., supra; Commissioner* v. *Rollins Burdick Hunter Co., supra; Commissioner* v. *Batten, Barton, D. & O., supra; Commissioner* v. *Air Reduction Co., supra; Aviation Capital* v. *Pedrick, supra; Helvering* v. *Edison Bros. Stores, supra; United States* v. *Stern Bros. & Co., supra.* These cases correctly hold that corporate gains from sales of treasury shares are taxable under Section 22(a) and the implementing Treasury Regulations irrespective of whether the corporation obligates itself in advance to purchase and resell the shares, or of whether the resales are made to employees or to outsiders. The gain "must be treated in the same way for tax purposes

whether the reason for the purchase of the shares is to carry out an existing obligation or is to take advantage of what seems to be a desirable business opportunity" (*Aviation Capital* v. *Pedrick*, *supra*, p. 167), for the "presence of contract restrictions and obligations did not put the resulting gain from actual purchases and sales beyond the reach of the statute as interpreted by the regulations" (*Commissioner* v. *Rollins Burdick Hunter Co.*, *supra*, p. 702).

3. As a further ground for its decision, the court below expressed "some doubt as to whether a corporation's purchasing and selling its own stock is not really a capital transaction." (R. 21.) This theory does nothing more than pose the basic question presented. Indeed it begs the issue by assuming that a profitable purchase and resale of treasury stock as a matter of law represents a tax-free readjustment of the corporation's capital, rather than a taxable transaction. Labeling a purchase-resale transaction a "capital transaction" furnishes no solution to questions of taxability. While the attendant gain or loss may be entitled to capital gain or loss treatment (see Section 117), the gain or loss must nonetheless be taken into account in computing taxable income.[24]

4. The court below further held that "the basis for the Circuit Courts' decisions is one of form only in that it rests entirely on the failure of the

[24] The Commissioner treated the gain here in question as long-term capital gain. (R. 30.)

corporation to go through the formal mechanics of actually retiring the stock and issuing new stock." (R. 21.) In other words, the court felt that the tax on a gain from a purchase-resale transaction could be avoided simply by retiring the purchased shares and issuing new ones, and that therefore the gain should not be taxed even though such steps are not taken and the shares are treated as treasury stock. This theory is fallacious for several reasons.

(a) To begin with, the differences between a purchase and resale of outstanding (treasury) stock, on the one hand, and a retirement of outstanding stock and an issuance of new stock, on the other, are more than matters of form. The corporation's capital structure is unaffected by a purchase and resale of previously issued and outstanding shares, whereas there is a reduction of its capital when such shares are retired and an increase of its capital when new shares are issued.[25] Accordingly, treasury shares may be sold free of the statutory or charter restrictions which usually surround the issuance of new shares. See *Commissioner* v. *Batten, Barton, D. & O.*, *supra*, pp. 476-477; *Commissioner* v. *Landers Corp.*, *supra*, pp. 191-192; *Borg* v. *International Silver Co.*, 11

[25] The general rule is that shares are not automatically cancelled and retired by the mere fact of purchase by the corporation. See Ballantine, *Manual of Corporation Law and Practice*, 233 (1930). The rule applies in Delaware, the state of taxpayer's incorporation, which prescribes the method for retiring stock in reduction of capital. See Revised Code of Delaware (1935), Section 2060.

F. 2d 147 (C. A. 2d).[27] A corporation which for reasons of its own chooses to avail itself of the advantages accorded by state law to treasury shares, is in no position to complain if for tax purposes the Government likewise recognizes a difference between the two.[28]

(b) Nor is there any warrant for the tacit assumption by the court below that a corporation could defeat the tax on a gain from a purchase and resale of the shares (or lose its rights to deduct a resulting loss) by merely retiring the purchased shares and issuing new ones. It is axiomatic that tax consequences flow from the substance rather than the form of a transaction, and in harmony with that principle this Court has many times held that what is essentially a single integrated transaction may not be broken up into its component steps. *Commissioner* v. *Court Holding Co.*, 324 U.S. 331; *Gregory* v. *Helvering*, 293 U.S. 465;

[28] For example, treasury shares, unlike new shares, may ordinarily be sold for less than par or stated value, free of subscription liability, and free of pre-emptive rights of stockholders. See Ballantine, *supra*, pp. 232-233, 422, 681; Revised Code of Delaware (1935), Sections 2046-2052; *Belle Isle Corp.* v. *MacBean*, 30 Del. Ch. 373, 379-380; *Karasik* v. *Pacific Eastern Corp.*, 21 Del. Ch. 81; *Kingston* v. *Home Life Ins. Co.*, 11 Del. Ch. 258, 263-264; *Yasik* v. *Wachtel*, 25 Del. Ch. 247, 252. In this case no preemptive rights attached to the common stock. (R. 27.)

[27] Whether reacquired shares are held as treasury stock or are retired will affect not only the federal income tax liability of the corporation, but that of the stockholder from whom the shares are reacquired. See Code Section 115(c), (g) and (i); *Alpers* v. *Commissioner*, 126 F. 2d 58, 60 (C.A. 2d); *Kirschenbaum* v. *Commissioner*, 155 F. 2d 23, 25 (C.A. 2d), certiorari denied, 329 U.S. 726; *Amelia H. Cohen Trust* v. *Commissioner*, 121 F. 2d 689, 691 (C.A. 3d).

Minnesota Tea Co. v. *Helvering*, 302 U.S. 609; *Higgins* v. *Smith*, 308 U.S. 473. If the transaction viewed as a whole is in reality a purchase and resale of the shares, the corporation should not escape tax on the attendant gain simply by going through the motions of retiring the reacquired shares and replacing them with an equivalent number of new ones. Cf. *Commissioner* v. *Landers Corp.*, *supra*, p. 192. To hold otherwise would exalt form above substance by permitting the corporation to disguise what in effect is but a substitution of stockholders—a purchase and resale of outstanding shares—as two independent and unrelated transactions: (1) a reduction of capital in partial liquidation of the business, followed by (2) an increase of capital in expansion of the business. Certainly a corporation which bought and sold its shares on a stock exchange could not circumvent the tax on the gain simply by cancelling the purchased shares and issuing new ones. The taxability of the gain likewise does not depend on the mechanics employed where, as here, the shares are closely held and are bought and sold directly between the corporation and its stockholders. The transaction would no more constitute a bona fide readjustment of the corporation's capital in the one case than in the other. It would produce nothing more than a change in the identity of the stockholders.[28]

[28] While state law variations as to the method of decreasing or increasing corporate capital would not be controlling for federal income tax purposes (cf. *Lyeth* v. *Hoey*, 305 U.S. 188, 194; *Helvering* v. *Stuart*, 317 U.S. 154, 161; *United*

(c) In any event, taxpayer's tax liability depends upon what it actually did, not upon what it might have done. A taxpayer does not escape tax liability on a taxable transaction, merely because it might have chosen a nontaxable method for achieving the same objective. *Founders General Co.* v. *Hoey*, 300 U.S. 268, 275; *United States* v. *Phellis*, 257 U.S. 156, 173; *Commissioner* v. *Rollins Burdick Hunter Co.*, *supra*, p. 701; *Commissioner* v. *Landers Corp.*, *supra*, p. 192; *Aviation Capital* v. *Pedrick*, *supra*, p. 167; *Dow Chemical Co.* v. *Kavanagh*, *supra*, p. 46. In the words of Mr. Justice Brandeis in the *Founders* case, *supra*, p. 275:

> It is suggested that in each case the taxpayer might have attained his ultimate purpose by a form of transaction which would not have subjected him to the tax. The suggestion, if true, furnishes no reason for relieving him of tax when, for whatever reason, he chooses a mode of dealing within the terms of the Act. * * * To make the taxability of the transaction depend upon the determination whether there existed an alternative form which the statute did not tax would create burden and uncertainty.

States v. *Gilbert Associates*, 345 U.S. 361, 364), it is noteworthy that even for purposes of applying the state corporation law, such a transaction would not be treated as a bona fide capital readjustment. See *Starring* v. *American H. & F. Corp.*, 21 Del. Ch., 380, 389, affirmed, 21 Del. Ch. 431.

Accordingly, it is unnecessary here to decide whether the gain in question would have been taxable if taxpayer had retired the purchased shares and replaced them with new ones. Whatever might be the tax result in such a hypothetical case, there can be no question as to the result where as here the shares are not retired but are purchased for resale and treated as treasury stock in the interim. In such a case it is abundantly clear that the purchase and resale do not constitute a bona fide partial liquidation of the corporation and a later original issue of stock for new capital. On the contrary, as the Courts of Appeals have uniformly held, the corporation then "deals in its own shares as it might in the shares of another corporation" within the meaning of the Regulations.

5. The reliance placed by the court below upon certain decisions of the Tax Court (R. 20-21) is misplaced, for the Tax Court has since shifted its position to conform with that of the Courts of Appeals. *Burrus Mills* v. *Commissioner*, 22 T.C. 881. The court below now stands alone in holding gains from sales of treasury shares to be tax-free. To permit the decision below to stand would grant to the taxpayer corporation a tax benefit which for over twenty years has been denied to other corporations similarly situated.

6. The error of the court below is made the more evident by its reliance (R. 23) upon *Eisner* v. *Macomber*, 252 U.S. 189. The question there decided was far different from the one here presented. It was there held that the distribution of

a stock dividend did not constitute a realized gain to a stockholder, but merely changed the form of his capital investment, since he had received nothing out of the corporation's assets for his separate use and benefit. As this Court only recently pointed out, the decision in that case "was not meant to provide a touchstone to all future gross income questions." *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, 431. See also *General American Investors Co.* v. *Commissioner*, 348 U.S. 434. Here, as in the *Glenshaw* and *General American Investors Co.* cases, the taxpayer realized an actual gain. The gain consisted of the difference between the cost and the selling price of its shares, and it unquestionably falls within the sweeping scope of Section 22(a). In the language of this Court in the *Glenshaw* case (p. 431): "Here we have instances of undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion." See also *United States* v. *Kirby Lumber Co.*, 284 U.S. 1; *Helvering* v. *Braun*, 309 U.S. 461.

Exceptions to the broad coverage of Section 22(a) should be made by Congress, not the courts. *Commissioner* v. *Glenshaw Glass Co.*, *supra*. Had Congress wished to carve out an exception to Section 22(a) in favor of corporate gains from sales of treasury shares, it could readily and simply have done so. It did do so in Section 1032 of the Internal Revenue Code of 1954, applicable to years after 1953.[29] Since the present case involves a

[29] See fn. 12, *supra*. This section correspondingly prohibits deduction of losses resulting from sales of treasury shares.

prior taxable year, that section is not applicable here. The tax consequences of gains or losses from dealings in treasury stock during years prior to 1954, for this taxpayer and all other corporations, are governed by the provisions of the 1939 Code.

CONCLUSION

The judgment of the Court of Claims should be reversed.

Respectfully submitted.

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IN THE

Supreme Court of the United States

October Term, 1954

No. 504

UNITED STATES OF AMERICA, *Petitioner*

v.

ANDERSON, CLAYTON & Co., *Respondent*

On Petition for A Writ of Certiorari to the United States Court of Claims

BRIEF FOR RESPONDENT IN OPPOSITION

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PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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BRIEF FOR RESPONDENT IN OPPOSITION

OPINION BELOW

The opinion of the Court of Claims is reported at 122 F. Supp. 837, and reproduced as an Appendix to the Petition.

JURISDICTION

The jurisdictional requisites are adequately stated in the Petition.

QUESTION PRESENTED

The question presented is whether, under Regulation 111, Section 29.22(a)-15, issued under Section 22(a) of the Internal Revenue Code of 1939, the Court of Claims correctly determined "upon examining the real nature of the transaction, considering all the facts and circumstances" that respondent was not dealing in its own shares as it might in the shares of another corporation.

STATUTES AND REGULATIONS INVOLVED

Section 22(a) of the Internal Revenue Code of 1939, and Section 29.22(a)-15 of the Treasury Regulations 111 promulgated thereunder are set forth in the Petition at pages 2-3.

STATEMENT OF FACTS

Those facts found by the Court of Claims and deemed most pertinent by respondent may be summarized as follows:

Anderson, Clayton & Co. was engaged in cotton merchandising in which able, experienced and interested management is of primary importance. (Finding 4, App. 11a[1]) Its capital structure was designed to assure such management. (Findings 3 and 5, App. 11a)

The capital structure was the result of the combined terms of the certificate of incorporation and an agreement between the holders of common stock and the corporation. The certificate of incorporation authorized 300,000 shares, par value $100, participating 4% cumulative first preferred, 75,000 shares, par value $100, participating 4% cumulative second preferred, and 2,856 non-par common. Common stock had no pre-emption rights. (Finding 15, App. 15a). The certificate established a Common Stock

[1]Appendix references are to the Appendix to the Petition.

Surplus to consist of the July 31, 1938, undistributed surplus increased each succeeding year by:

(1) Five Dollars per share on all common stock outstanding; and

(2) Four Per Cent per annum on the common stock surplus balance. Additional surplus constituted "Participating Stock Surplus", one-half belonging to the preferred and one-half to outstanding common. (Finding 16, App. 15a) As of July 31, 1943, the taxpayer had 326,852 shares of preferred stock of a total par value of $32,685,200 outstanding, and 84,083 shares, or $84,083 stated value of common stock outstanding for corporate purposes.[1] (Findings 19, 20 and 21, App. 16a-17a)

The agreement between the corporation and the common stockholders required the trusteeing of the stock, though the stockholder retained the right to vote and receive dividends. Transfers or assignments required written consent of 75 per cent of the stockholders. At death of the holder the corporation was obligated to buy the common stock at its value determined under the contract and the certificate of incorporation, as of the preceding July 31, and the holder's estate was obligated to sell. Similar obligations existed upon withdrawal or dismissal. (Finding 6, App. 12a and 13a)

Transfers were confined to managerial executives, (Finding 9, App. 14a) and made in recognition of increased responsibility and duties. (Finding 5, App. 11a; Finding 8, App. 13a; and Findings 10 and 12, App. 14a)

At M. D. Anderson's death his 18,574 shares of common stock were acquired at the specified contractual value of $50.79 a share and the cost over the $1 stated value was charged to the Surplus Allocated to Common Stock. Prior to the instant transaction 4,035 shares were sold to executives at the lower prevailing values of $32.27 and $33.62,

[1] 18,773 shares of common stock were technically held in the treasury but were not considered outstanding under the certificate or contract. (Finding 25, App. 18a)

the excess over $1 stated value being credited to the common stock surplus. (Finding 22, App. 17a) So long as they were held in the Treasury, shares of common stock were treated as non-existent for all purposes. (Finding 25, App. 18a.; Finding 16, App. 15a; Finding 18, App. 15a and 16a)

During its fiscal year ending July 31, 1944, Anderson, Clayton & Co. allocated and sold 6,500 shares of this stock reacquired from M. D. Anderson to certain managing officials at $112.68 a share in recognition of increased responsibility and duties. (Finding 10, App. 14a) This was the current contractual valuation of each share of the common stock outstanding, as of July 31, 1943, after deduction of an intervening $10 a share dividend. (Findings 21 and 23, App. 17a)

The stated $1 per value of the common stock, which represented its capital under the laws of Delaware, was nominal and the substantial value of such stock was represented by the Common Stock Surplus and the Participating Surplus which amounted to $111.68 per share as of July 31, 1943, after deduction of the $10 dividend declared on November 30, 1943. (Finding 28, App. 18a)

Under the certificate of incorporation, the agreement between the corporation and its common-stock holders and the method of accounting there required and consistently followed, the respective purchases and sales of common stock amounted in substance, in the case of purchases by the corporation, to the withdrawal by the stockholder of earnings accumulated during the period of the ownership of such stock, and in the case of sales by the corporation to new managers to a contribution of capital in an amount equal to accumulated earnings so as to equalize the common equity of all stockholders and the distributions during the ownership of such stock by the executive permitted to buy it. (Finding 27, App. 18a)[1]

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[1] Petitioner omits this substantial finding from its statement of facts relying upon the view that this finding of the

The purchase of the 18,574 shares of the common stock from M. D. Anderson in 1939 was in conformity with the plan that the common stock should be held only by and sold only to active management. The purchase by the corporation was not for the purpose of investment or to deal in its common as it would the stock of another corporation. Under the stockholders agreement with the corporation such common stock could be sold only to persons and upon such terms as might be agreed upon in writing by the holders of 75 per cent of the stock held by the trustee. Such stock could not be issued or transferred by the corporation until the stockholder executed acceptance of the agreement. (Finding 28, App. 18a and 19a)

The sale of 6,500 shares of the common stock to various junior officials in December, 1943, was to adjust the respective holdings in the common stock in accordance with responsibility and to reward managerial performance by the ownership of common stock which would keep cash in the business and compel the executives to acquire the proprietary interest deemed essential, and not for the purpose of dealing in its stock as it would the stock of another corporation. (Finding 29, App. 19a)

REASONS FOR DENYING WRIT

1. The conflict between the decision below and those of various Circuit Courts of Appeal is limited to the question whether "the one factor of failing to actually retire the stock is controlling".

The opinion of the Court of Claims made it clear that it differed with the Circuit Courts' view "considering the one factor of failing to actually retire the stock as controlling". (App. 10a) That was the view urged upon it by petitioner,

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Court of Claims, as well as Findings 28 and 29, constitute conclusions of law (Petition, page 4, footnote 4) Respondent disagrees. With minor language clarifications made by the Court of Claims these are the identical findings of fact reported by the Commissioner, and represent the careful judgment of the Commissioner, and the Court. (See Record, pages 23 and 24) Petitioner filed no exceptions to these findings of the Commissioner.

in spite of the clear and positive provision of the regulations that the question "depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances".

Insofar as every practical aspect of the transaction was concerned the Court of Claims correctly concluded that it was entirely a matter of form whether or not treasury stock or unissued stock was utilized. Retirement of the 18,574 shares representing a stated capital of $18,574 acquired by the corporation at the death of M. D. Anderson required only filing a formal certificate with the State of Delaware. Compared to existing capital of more than $32,000,000 it was truly *de minimis*. Under the Certificate of Incorporation the Directors had full discretion to issue common stock to such persons and for such consideration as they wished. Under the contract between the corporation and the common stockholders the issuance, ownership, and transfer were all closely limited to management. Treasury common was as immobilized for every purpose as unissued common stock. (Finding 25, App. 18a; Finding 16, App. 15a) The corporation had no more and no less freedom in disposing of one than the other. In the case of either, the stated capital of $1 a share represented by any acquisition or disposition was inconsequential.

While some of the purposes involved in the Circuit Court cases cited by petitioner as contrary are similar to those which actuated the capital structure here involved, none of them even remotely accomplished the effect achieved here. The findings of the Commissioner and the Court of Claims in this case distinguish it from any other; and if the regulation is controlling, as *Helvering* v. *Reynolds*, 306 U.S. 110, indicates, the differing decisions are based on the particular facts.

That the Court of Claims regarded its decision as based upon these particular facts is plain from the opposite result it reached in *Edwin L. Wiegand Co.* v. *United States*, 104 C. Cls. 111, 60 F. Supp. 464, which as Judge Littleton,

who wrote both opinions, stated "is distinguishable on the facts". The Court of Claims sustained the regulation in the *Wiegand* case but held that the very different bundle of rights and obligations,—of "facts and circumstances."—resulted in taxable gain. Indeed, the factual situation there was quite comparable to those involved in the decisions of the Circuit Courts which petitioner urges as conflicting. The different result by the same court and judges emphasizes that the only real conflict is one of theory, as to whether the failure to retire the stock involved is controlling, or simply one of the numerous facts and circumstances to be considered.

2. The decision below correctly applies the Regulations to the facts found.

In *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U.S. 110, the Court held that Section 22(a) was so general in its terms as to render an interpretative regulation appropriate and controlling. The earlier regulation involved there and applied by the Court provided expressly that a corporation realized no gain from the sale of its capital stock.

The Court of Claims applied the present regulation to the facts as it determined them; and without openly adopting that position the petitioner is seeking to overturn or disregard the plain terms of its own regulations. If the earlier regulations were appropriate under Section 22(a) and controlling upon petitioner, as the Court held in the *Reynolds* case, then under that decision either the rule of the old regulations is embodied in the statute itself,[1] or the new regulation is appropriate and binding upon petitioner.

The decision of the Court of Claims was based directly upon the regulations. It determined that:

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[1] In the *Reynolds* case, the Court expressly stated it did not need to determine whether the Treasury could change the regulations to its present form without legislative sanction. (Pages 116-117) In the 1954 Code Congress specifically wrote into Section 1032 the terms of the earlier regulation.

"Upon examining the real nature of the transaction, considering all the facts and circumstances, we arrive at the conclusion that plaintiff was not dealing in its own shares as it might in the shares of another corporation." (Appendix 9a to Petition)

Finding 27, (App. 18a) contains its finding of fact as to the real nature of transaction, as follows:

"Under the certificate of incorporation, the agreement between the corporation and its common-stock holders and the method of accounting there required and consistently followed, the respective purchases and sales of common stock amounted in substance, in the case of purchases by the corporation, to the withdrawal by the stockholder of earnings accumulated during the period of the ownership of such stock, and in the case of sales by the corporation to new managers to a contribution of capital in an amount equal to accumulated earnings so as to equalize the common equity of all stockholders and the distributions during the ownership of such stock by the executive permitted to buy it."

That finding was first made by the Commissioner, was not excepted to by the petitioner and was adopted by the Court of Claims with minor language clarifications. It embodies a finding of ultimate fact, which in earlier practice was conclusive, (*Niles Bement Pond* v. *U. S.*, 281 U.S. 357; *United States* v. *Esnault-Pelterie*, 299 U.S. 201) and is obviously not "clearly erroneous" if that be the test now applicable. (*United States* v. *Yellow Cab Co.*, 338 U.S. 338; *United States* v. *U. S. Gypsum Co.*, 333 U.S. 364)

It may also be noted that in an earlier case involving this common stock, *Estate of Monroe D. Anderson* v. *Commissioner*, 8 T.C. 706, 719, the Tax Court stated:

"In other words, the common stock was designed not to be marketable, but to be held in direct proportion to the active participation of each stockholder in the business enterprise."

The substantial effect of the transaction, as well as its purpose, support the judgment of the Court below. The effect achieved, as well as intended, was, for example, to give Harmon Whittington to whom was allocated 2,000 shares an interest in earnings, above stated returns on preferred, equal to [redacted] a share or an additional $10,000 a year and 4 per cent on the amount paid in to the Common Stock Surplus to equalize his position with that of the other 84,083 shares outstanding. (See Finding 27, App. 18a; and Findings 15 to 21, inclusive, App. 15a to 17a) Had he died or withdrawn next day, his interest would have terminated and the corporation would have paid his estate the same amount paid in with one day's interest. (Finding 18, App. 15a) The benefit to the corporation depended upon the usefulness of his services, and that was what the common stock structure was designed to secure.

Respondent did not formally reduce its stated capital when it purchased the 18,574 shares of its non-par common stock from M. D. Anderson. It did not formally increase its stated capital when it issued the 6,500 shares to its newer managing officials. But as the findings show it accomplished substantially that by the use of a nominal $1 value of such stock, and the treatment of Common Stock Surplus as a capital deposit under the provisions of the certificate of incorporation and the stockholders agreement. Respondent had $943,373.46 less capital funds at its disposal after it paid the M. D. Anderson Estate the amount required by the trust agreement; it had $732,420 more when it transferred 6,500 shares to Harmon Whittington and associates in 1943.

Each of these transactions, moreover, had the effect of readjusting the income and priority as to earnings between the preferred and common stockholders.

While the respondent had 84,083 shares of common stock outstanding, the common stockholders were entitled to $420,415 plus 5% on the Common Stock Surplus or a total second priority of $623,352.80 for the year ended July 31,

1943. When the 6,500 shares were issued again to junior management this action of itself increased this preference by $32,500 ($5 x 6500) plus approximately $17,500 interest on the amount paid in to the Common Stock Surplus, or a reshuffling of common stock priority to income in the amount of $50,000 per annum. The novel but express provisions of the certificate of incorporation effected this readjustment. (Finding 16, App. 15a)

Based upon the real nature of the transaction, considering all the facts and circumstances, the Court below could reach no other conclusion than that this was a capital transaction, resulting in no gain to the corporation under the express terms of petitioner's own regulations.

3. This case is not only unimportant for any purpose under the 1954 Internal Revenue Code, but, with its entirely novel facts, is of limited importance otherwise.

Effective January 1, 1954, Section 1032 of the Internal Revenue Code of 1954, expressly provides that:

> "No gain or loss shall be recognized to a corporation on the receipt of money or other property in exchange for stock (including treasury stock) of such corporation."

Concerning this section of the Code the House Ways & Means Committee (House Report 1337, 83rd Congress, Second Session, page A268) and the Senate Finance Committee (Report No. 1622, 83rd Congress, Second Session, page 426) state:

> "Under present law, whether the disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends, under certain decisions, upon whether the transaction constitutes the dealing by a corporation in its own shares which is to be ascertained from all of the facts and circumstances. The purpose of this section is to remove the uncertainties of present law."

Congress has thus clearly established as its intended rule, which petitioner admits settles the rules for years after 1953, that no gain or loss is to be recognized from sale by a corporation of its own capital stock.

Clearly, the decision below is unimportant for future years and since it was not decided until July 13, 1954, it obviously could not serve as a pattern for any other transaction.

Petitioner mentions two other pending cases, involving the same general question it poses. *Timken-Detroit Axle Co.* v. *Commissioner*, 21 T.C. 769, pending in the Sixth Circuit, involves the year 1947 and the sum of $68,541.52. That same Circuit decided the very similar case of *Commissioner* v. *Landers Corp.*, 210 F. (2d) 188, in petitioner's favor. The only other case actually cited is *Burrus Mills, Inc.* v. *Commissioner*, 22 T.C. , No. 107, now pending on taxpayer's appeal to the Fifth Circuit. It involves a fiscal year ended May 31, 1947 and the amount of $30,650.

Factually, neither of these cases is comparable to the present case. In *Timken-Detroit Axle Co.* v. *Commissioner*, *supra*, a casual, unconditional sale of treasury stock to an individual whom the company wished to persuade to remain in its employ was involved. *Burrus Mills, Inc.* v. *Commissioner*, *supra*, involved a sale of ordinary common stock under a general employee stock purchase plan.

Neither case involves a special issue of managerial stock, controlled in every respect by a binding agreement between every holder and the corporation, both designed and effective only to give the managerial holder his proper share in the earnings while he was actively participating in management.

Respondent cannot, of course, know the accuracy of petitioner's estimate as to the amount involved in other pending cases, but it can be stated confidently that none of them involves facts, which bring them so plainly within petitioner's regulations, as does the instant case.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

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January 24, 1955

SUPREME COURT, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1955

No. [redacted]26

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On Writ of Certiorari to the United States Court of Claims

BRIEF FOR RESPONDENT

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PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1955

No. [redacted]26

UNITED STATES OF AMERICA, *Petitioner*

v.

ANDERSON, CLAYTON & CO., *Respondent*

On Writ of Certiorari to the United States Court of Claims

BRIEF FOR RESPONDENT

OPINION BELOW

The opinion of the Court of Claims (R. 15-23) is reported at 122 F. Supp. 837.

JURISDICTION

The jurisdictional requisites are adequately stated in the Government Brief.

QUESTION PRESENTED

The question presented is whether Treasury Regulations 111, Sec. 29.22(a)-15 is effective to make every sale of treasury stock a taxable transaction.

REGULATIONS INVOLVED

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

> Sec. 29.22(a)-15. *Acquisition or Disposition by a Corporation of its Own Capital Stock.*—Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.
>
> But if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of the Internal Revenue Code.

STATEMENT OF FACTS

There was little controversy as to the facts before the Court of Claims, and, following the hearing, the parties filed a joint request for findings of fact, which the Commissioner found as requested, and which the Court of Claims followed with minor editorial changes. It is difficult, in fairness, to reduce the statement of facts of the court below; but since in taxpayer's opinion the question before the Court is different from that stated by the Government, its view as to the material facts likewise differs considerably and such facts are, therefore, stated as follows:

Anderson, Clayton & Co. was organized in 1929 to engage in cotton merchandising, a highly complex business dependent primarily on expert, experienced and interested management. Its capitalization, originally $25,842,375 of 6% preferred, and 100,000 shares of stated value $1 no par common, was designed to have the preferred stock represent existing values and so that the common could be used to adjust the participation of the managing officials in future earnings above the contracted return on the outstanding preferred. (R. 23-24)

The 100,000 shares of common stock was issued to existing management in relation to existing experience, position, and responsibility, with the understanding that its distribution would be readjusted among the managerial group as responsibility changed, and that its distribution would be controlled by 75 per cent of the common stock and the corporation. (R. 24)

Restrictions were placed upon the payment of cash dividends on the common stock, but the stockholder was entitled to withdraw at any time and the corpora-

tion, absent agreement on price, was obligated to pay him its value determined on the preceding July 31, plus interest. Purchase by the corporation at such value was automatic upon death of the holder. The stock was all held by a trustee under an agreement between the corporation and all common stockholders embodying such terms and others designed to insure that only active responsible management could own common stock. (R. 24-25)

From time to time as junior officials assumed more responsibility shares of the $1 common stock, after dividends in second preferred restored its value to a dollar, were transferred to them by the two chief managing officials, W. L. Clayton and M. D. Anderson, so that upon his death in 1939 M. D. Anderson held only 18,574 of the 31,000 shares originally issued to him. (R. 26)

At the times of the transactions involved the authorized capital stock consisted of 300,000 shares, par value $100, participating four per cent cumulative first preferred, 75,000 shares, par value $100, four per cent cumulative second preferred, and 102,856 shares of common without nominal or par value. No preemptive rights existed as to common stock which could be issued at the discretion of the Board. (R. 27)

After provision for cumulative preferred dividends the common stock was entitled to prior distribution of a Common Stock Surplus, consisting of the undistributed surplus on July 31, 1938, increased each succeeding year by:

(1) Five Dollars per share on all common stock outstanding; and

(2) Four per cent per annum on the Common Stock Surplus balance.

Any remaining undistributed surplus constituted Participating Stock Surplus, belonging one-half to preferred and one-half to common. (R. 27)

By an instrument executed on April 16, 1943, the agreement between all the holders of common stock and the corporation was revised and continued until August 1, 1953. The instrument provided that the value at which such stock was to be purchased in case of death or withdrawal should be $1 a share plus the proportionate interest of the outstanding stock in the Common Stock Surplus and Participating Surplus determined as of the preceding July 31. (R. 28, R. 75-73)

Upon the death of Mr. Anderson, the taxpayer, in accordance with the agreement, purchased his 18,574 shares at the contract value of July 31, 1938, which with interest, amounted to $50.79 a share, or a total of $943,373.46. The cost over the $1 stated value of 15,539 of these shares was charged to the Surplus Allocated to Common Stock account. (R. 27-28) The remaining 3,035 shares of this particular stock were sold to another company official in accordance with the agreement, based on the July 31, 1939, contract value of $32.27 a share and the net "loss" of $18.52 a share or $56,208.20 was charged directly to the Surplus Allocated to Common Stock account. (R. 28) This stock was not retired but was held as treasury stock. While in the treasury no dividends could be paid on it and it could not be voted. (R. 29) Also 1,000 of these shares were sold in 1941 at $33.62 a share and the $32,620 over stated value was credited to the Surplus Allocated to Common Stock account reflecting a "loss" of $17,170 on these shares. (R. 28)

On December 18, 1943, 6,500 shares of the Common Stock was allocated and sold in accordance with the agreement of April 16, 1943, to certain managing officials at the July 31, 1943, contracted valuation of $112.68 a share. The corporation took the notes of the officials in payment and counsel stipulated that for the purposes of this case the $112.68 might be treated as though it were a cash sales price. (R. 26) Under such notes the purchaser had the right at his option to deliver back the stock in full satisfaction of his note. (R. 78) The amount over the $1 stated value was credited to the Capital Surplus Account. (R. 28)

The common stock bought from shareholders was not cancelled or retired but the shares outstanding less those held in the treasury were used in all financial statements, in the payment of dividends, in arriving at the par share values under the agreement. Treasury stock was not voted at meetings of shareholders nor taken into account in payment of dividends. During the taxable year involved there was no authorized unissued stock. (Finding 25, R. 29)

The stated $1 per share value of the Common Stock, which represented its capital under the laws of Delaware, was nominal and the substantial value of such stock was represented by the Common Stock Surplus and the Participating Surplus which amounted to $111.68 per share as of July 31, 1943, after deduction of the $10 dividend declared on November 30, 1943. (Finding 26, R. 29)

Under the certificate of incorporation, the agreement between the corporation and its common-stock holders and the method of accounting there required and consistently followed, the respective purchases and sales of common stock amounted in substance, in the case of

purchases by the corporation to the withdrawal by the stockholder of earnings accumulated during the period of the ownership of such stock, and in the case of sales by the corporation to new managers to a contribution of capital in an amount equal to accumulated earnings so as to equalize the common equity of all stockholders and the distributions during the ownership of such stock by the executive permitted to buy it.' (Finding 27, R. 29)

The purchase of the 18,574 shares of the common stock from M. D. Anderson in 1939 was in conformity with the plan that the common stock should be held only by and sold only to active management. The purchase by the corporation was not for the purpose of investment or to deal in its common stock as it would the stock of another corporation. Under the stockholders agreement with the corporation such common stock could be sold only to persons and upon such terms as might be agreed upon in writing by the holders of the 75 per cent of the stock held by the trustee. Such stock could not be issued or transferred by the corporation until the stockholder executed acceptance of the agreement.' (Finding 28, R. 29)

The sale of 6,500 shares of the common stock to various junior officials in December 1943, was to adjust the respective holdings in the common stock in accordance with responsibility and to reward managerial performance by the ownership of common stock which would keep cash in the business and compel the executives to acquire the proprietary interest deemed essen-

[1] The Government Brief, page 7, argues that these findings by the Court of Claims, Nos. 27-29 inclusive, are merely conclusions, but certainly to the extent they are conclusions of fact requested and agreed to by the Government in the court below, they are binding upon the parties.

tial, and not for the purpose of dealing in its stock as it would the stock of another corporation.[1] (Finding 29, R. 29-30)

Upon original issuance the corporation received $1 a share for its Common Stock, or $18,574, for the stock repurchased in 1939 from the M. D. Anderson estate. This repurchase of the 18,574 shares of Common Stock on December 15, 1939, at $50.79 a share from the M. D. Anderson estate reduced the assets of the corporation by the amount of $943,373.46. The sale of 3,035 shares to W. L. Anderson on December 22, 1939, at $32.27 a share increased the net assets by $97,939.45, and the sale of 6,500 shares at $112.68 a share on November 30, 1943, increased the assets of the company by the amount of $732,420. (Finding 30, R. 30)

The Commissioner determined that taxpayer realized a taxable long term capital gain of $402,285.00 from the sale of the 6,500 shares and a resulting tax of $100,511.25 was paid, and recovery sought and allowed by the Court of Claims in the instant suit. (R. 30)

SUMMARY OF ARGUMENT

The Court of Claims has determined upon undisputed facts that, considering all the facts and circumstances, taxpayer did not deal in its stock as it might the stock of another corporation, and that under the plain terms of the applicable regulations taxpayer realized no taxable gain from the sale of its treasury common stock to management.

The decision of this Court in *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U.S. 110, established that whether an increment to assets from a sale of treasury

[1] For footnote, see p. 7.

stock is income is at least a debatable question, and that the administrative construction excluding it had acquired the force of law through repeated Congressional reenactment of Section 22.

The revised regulation, Sec. 29.22(a)-15 of Regulations 111, is specific as to the exclusion of original issues of stock and as to the inclusion of stock received as consideration upon the sale of property or in satisfaction of indebtedness, but insofar as applicable to the instant transaction provided that the question hinged upon the real nature of the transaction to be ascertained from all its facts and circumstances, and whether the corporation deals in its own shares as it might the shares of another corporation. The language used shows no clear intent to change, nor is it sufficient to effect a change, in the law as determined in *Helvering* v. *R. J. Reynolds*, *supra*. Clear, unambiguous language is as necessary to bring a transaction within a taxing regulation, as within a tax statute, and the taxpayer must be given the benefit of any doubt or uncertainty as to whether the transaction is covered. Congress expressly confirmed the *Reynolds* case rule in Section 1032, Internal Revenue Code of 1954, in order to remove the "uncertainties of existing law" which arose with the recent series of Tax Court and Court of Appeals decisions.

No aspect of the transaction involved resembled dealing in its own stock as taxpayer might in the stock of another company. The stock was in the treasury as a result of the 1939 death of an important managing official and the automatic payment to him of its contractual value based on the earnings and profits during his tenure. It was allocated and sold in December, 1943, to readjust the share of certain other officials in

earnings, and for a price calculated to equalize its position with that of the outstanding common. The stock involved was no par common with a nominal $1 stated value, created and distributed to effect a fair adjustment of corporate earnings above a return on capital. The stock was never purchased for investment, nor with any view to a profit from its resale. While it was in the treasury every right such share embodied when outstanding disappeared.

It is doubtful whether a purchase or sale of its own stock by a corporation can be anything but a capital transaction. Since a share of stock represents a group of contractual rights against the corporation, its acquisition effectively terminates those rights, for a person can scarcely be liable to itself. Recognized accounting principles require the elimination of treasury stock from assets, and the inclusion of any amount received from its reissuance in capital. In formulating rules designed to protect investors the Securities & Exchange Commission requires that all transactions in treasury stock be treated as capital in nature. In the field of national banks Congress has recognized and this Court affirmed that the purchase of its stock retires capital and its resale restores it. From every commercial viewpoint that is what occurred here.

The decisions of the Courts of Appeal relied upon by the Government ignore the plain terms of the regulations and as the Court of Claims points out are based entirely on the failure of the taxpayer to go through the formal mechanics of actually retiring the stock and issuing new shares when the occasion to do so should arise.

Under Delaware law and the provisions of taxpayer's Certificate of Incorporation the only distinction be-

tween treasury stock and unissued stock was formal. Either as treasury shares or newly issued shares the no-par common could be sold at any price, not involving fraud, determined by the Directors. No preemptive rights existed. Both the Delaware law and the corporate charter authorized the reissuance of any shares formally retired. Every significant right represented by a share disappeared in the treasury and for every practical business purpose it was valueless and meaningless.

Contrary to the controlling importance the Government seeks to give the fact that the treasury shares rather than newly issued shares were involved here, it attaches no significance to this question in other tax fields. It recognizes that a dividend in treasury stock is a non-taxable dividend. It taxes stockholders with the proceeds of stock redeemed and held in the treasury, and it has required the elimination from invested capital of an amount paid for treasury stock unless it is held for investment. In each of these fields the courts have refused to recognize that treasury stock is property, or that its purchase or sale left the capital of the corporation unaffected.

From the undisputed facts the Court of Claims determined that the 1943 transaction of the taxpayer in its stock was not brought within the terms of Section 22 taxable income by the applicable regulation.

ARGUMENT

The Applicable Treasury Regulations Are Ineffective to Reverse Preexisting Rules Embodied in Law That Transactions by a Corporation in Its Stock Like That Involved Here Were Capital in Nature

Here, as in *Eisner* v. *Macomber*, 252 U.S. 189, the problem is one of "distinguishing gain from capital". *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426. "Whether the increment is income is at least a debatable question", and an interpretative regulation is appropriate. *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U.S. 110, 114.

The regulation applicable there provided plainly enough that:

> "If * * * the corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not constitute income of the corporation. A corporation realizes no gain or loss from the purchase or sale of its own stock."

As the Court of Claims said here:

> "This rule was reasonable, logical and in accord with the accountants' view." (R. 19)

In May 1934 after the Court of Appeals for the First Circuit held in *Commissioner* v. *S. A. Woods Machine Co.*,[2] (1932) 57 F. (2d) 635, that a corporation realized

[2] Except on the ground that what was really involved was a collection of indebtedness and not a purchase of its stock the result in this *Woods* case ignores entirely the regulation held controlling by this Court in *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U.S. 110. There has been and is no controversy regarding the realization of taxable income from such transactions as to which the new regulations were quite specific. (Government Brief, p. 25, footnote 16.)

gain when it received its own stock which it immediately retired, in settlement of patent infringement damages, the Commissioner rewrote the regulation to read that:

> "Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.
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> "But if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of the Internal Revenue Code."

In *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U.S. 110, 115 this Court definitely held that:

> "* * * Under the established rule Congress must be taken to have approved the administrative construction and thereby to have given it the force of law."

Since Congress had thus excluded transactions of this sort from the tax, definite action by Congress or by authorized regulation is surely necessary to bring such transactions within the tax. Inclusion in gross income, not exemption, is involved.

Assuming, as this Court refused to decide in the *Reynolds* case, that the Treasury could change for the future a rule which had become incorporated in the law,[3] the burden is surely upon the Treasury to show that it did so. If its action is not clear, then its regulation, as much as a statute itself, is in case of doubt to be "construed most strongly against the government, and in favor of the citizen." *Gould* v. *Gould*, 245 U.S. 151.

While this new regulation abandoned the simple positive rule that a corporation realized no gain or loss from purchase or sale of its own stock, it is specific only in excluding receipt by the corporation of subscription to original issues and in including receipt of stock as consideration upon the sale of property or in satisfaction of indebtedness. Otherwise and insofar as it is pertinent here the only guidance available to taxpayers in 1943 in determining whether the previously applicable rule had been reversed is found in these sentences:

> "* * * * Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. * * *

[3] In *Helvering* v. *Wilshire Oil Co.*, 308 U.S. 90, the Court upheld Treasury authority to change a legislatively approved rule by definite exercise of its continuing rule-making power. There was no ambiguity in, or doubt as to, the meaning of the regulation there.

"But if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. * * * "

The Government's position basically is that this language is window-dressing,—to be ignored,—and that the regulation really means that no sale of its stock by a corporation is a capital transaction except on original issuance. That language would have been simple and readily understandable. But the Treasury chose deliberately to state its administrative rule in the general and uncertain terms quoted, imposing upon tax tribunals the responsibility of exploring the real nature of the transaction considering all the facts and circumstances and deciding then whether the corporation had dealt in its stock as it would the stock of another corporation. Had the Treasury clearly intended to include all sales of treasury stock in taxable transactions, it could readily have done so.[4]

[4] Regulations 33, Art. 98, issued under the Revenue Act of 1916, but reversed in Regulations 45, Article 542, provided:

"Reg. 33 (Rev.), Art. 98, 362 and 363. Treasury stock—When taxable.—Treasury stock, whatever and whenever that term is used in connection with the accounts of the corporation or for income-tax purposes, will be held to mean stock which had been previously issued by the corporation and which had been repossessed by it through purchase or otherwise and then carried on its books as an asset. If such stock is resold at a price in excess of its cost upon repossession, such excess shall be returned as income for the year in which resold. Unissued stock, which had been retained by the corporation for the purpose of future sale, will not, for the purpose of the income tax, be considered 'Treasury stock,' and when sold no part of the proceeds of such sale will be considered taxable income. Nor will there be any deductible loss if such stock is sold at a price less than par."

Assuming the authority of the Treasury to change a rule which this Court held has congressional approval and the force of law, this ambiguous, general language is scarcely a proper or effective method of changing the law. It is significant that upon its first consideration of this subject after the new regulation was issued Congress expressly enacted the "reasonable, logical" rule of the earlier regulations, for the purpose, according to the tax committees, of removing "the uncertainties of present law." (Section 1032, Internal Revenue Code of 1954, House Report 1337, 83rd Congress, Second Session, Page A 268; Senate Report No. 1622, 83rd Congress, Second Session, page 426) This action, the first consideration of Congress after the changed treasury regulations, indicates that the government interpretation of the Treasury Regulations misinterprets Congressional intention. *Jackson* v. *Commissioner*, 172 F. (2d) 605, p. 607.

The Court of Claims Finding That the Taxpayer Did Not Deal in Its Own Shares as It Might the Shares of Another Corporation Is Supported by the Undisputed Facts

Proper application of the interpretative principles applicable to a tax imposing law or regulation would seem to require that the facts bring the transaction clearly within the terms of the law or regulation. Unless, therefore, taxpayer *dealt in*[5] its own shares as

[5] The words "deal in" involve the purchase and sale of goods for the purpose of gain. As early as *Fleckner* v. *The Bank of the United States*, 21 U.S. 338, 351, the Court had before it the question whether the Bank had, contrary to law, engaged in "dealing or trading in" promissory notes. It said:

> "The true interpretations, however, of that rule is, not that it prohibits purchases generally, but that it prohibits buying

it might the shares of another corporation, the Treasury Regulation does not bring the transaction within the scope of the tax.

It is difficult to imagine a transaction less like dealing in the shares of another corporation than that involved here.

The whole arrangement, created by the certificate of incorporation, the agreement between the corporation and all the common stockholders, and the understanding among such stockholders, contemplated that the common stock would be used only to adjust the participation of active managing officials in earnings above a specified return on capital. (R. 23-24)

The automatic acquisition of the 18,574 shares from the M. D. Anderson estate in 1939 was pursuant to the agreement and plan (R. 29), and amounted in substance to the withdrawal by the Anderson estate of earnings accumulated during his period of ownership. (Finding 27, R. 29) The purchase was not for the purpose of investment or to deal in its common stock as it would the stock of another corporation. (Finding 28, R. 29)

And when in December, 1943, it was decided by the corporation and the common stockholders that an ad-

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and selling for the purposes of gain. It aims to interdict the bank from doing the ordinary business of a trader or merchant, in buying and selling goods, etc., for profit, and uses the words 'deal' and 'trade' in contradistinction to purchases made for the accommodation or use of the bank, or resulting from its ordinary banking operations."

In determining whether a taxpayer was a dealer in securities both the Treasury and the Court regarded it as important that the taxpayer should have bought or sold the securities with a view to the gains and profits to be derived therefrom. *Helvering* v. *Fried*, 299 U.S. 175.

justment of the share in earnings of certain junior officials was justified, 6,500 shares were allocated to them, And the price fixed for payment, i.e. $112.68 (R. 26), amounted in substance to a contribution of capital in an amount equal to accumulated earnings so as to equalize the common equity of all stockholders and the distribution during the ownership of such stock by the executive permitted to buy it. (Finding 27, R. 29)

While it was held as treasury stock, every effective right a share represents disappeared. It had no vote, was entitled to no distributions, could not be counted for quorum purposes, and was not even effective to increase the annual addition to the Common Stock Surplus. (R. 29, R. 27)

Against these admitted facts, found by the Court of Claims upon the joint request of the parties, the Government has only the fact that the corporation did not formally retire the shares when they were purchased. (R. 29)

None of the usual indicia of dealing in the stock was present. Its utilization was definitely limited. No purchase was made with a view to reselling at a profit. No continuing purpose or intent to resell existed, and some continued to remain in the treasury. (R. 43) It was bought in accordance with the corporation's stockholders contract, and independently sold when a readjustment of the share in earnings of junior management became in order.

The Court of Claims determined that taxpayer did not deal in its stock as it might the stock of another corporation and its determination is adequately supported by the undisputed facts embodied in its agreed

findings. *United States* v. *Yellow Cab Co.*, 338 U.S. 338; *United States* v. *U. S. Gypsum Co.*, 333 U.S. 364; *Niles Bement Pond* v. *United States*, 281 U.S. 357; *United States* v. *Esmault-Pelterie*, 299 U.S. 201.

The Need for Careful Consideration of All the Facts and Circumstances by the Appropriate Tribunal Is Clear from the Doubt Whether a Corporation's Purchase and Sale of Its Own Stock Can Be Anything But a Capital Transaction

While the Court below determined that the taxpayer was entitled to recover under the plain terms of the regulations, it stated its doubt as to whether a purchase and sale of its own stock by a corporation could be anything but a capital transaction. That position is strongly supported by basic corporate legal theory and by recognized accounting and business principles.

Corporate theory scarcely permits the acquisition or disposition by a corporation of its own stock to be treated as anything but capital transactions. As an artificial being,[6] existing only in contemplation of law, whose creature it is, the nature of the corporation and its relations with its shareholders have demanded considerable attention from the courts.

Since the Dartmouth College case the charter of a corporation has been regarded as a contract between the corporation and the state and between the corporation and its stockholders. *Lawson* v. *Household Finance Corp.*, 17 Del. Ch. 343, 352. In *Morris et al.* v. *American Public Utilities Co.*, 14 Del. Ch. 136, the Court said:

> "That a corporate charter is a contract has long been settled. In *Gavez* v. *St. Joe Mining Co.*, 32

[6] *The Trustees of Dartmouth College* v. *Woodward*, 4 Wheat 518.

> Utah 497, 513, 91 Pac. 369, 374 (12 L.R.A. (N.S.) 554), it is spoken of as 'a dual contract—one between the state and the corporation and its stockholders, the other between the corporation and its stockholders.' That there is a third aspect in which the contract may be regarded would appear clear, for not only is there a contractual tie binding in the two respects observed by the Utah Court but there is as well a contractual relation in many particulars existing between the stockholders *inter sese*.[7]

If the stockholder-corporation relationship is one of contract, as is clearly the case, then when the corporation acquires a share, the contract must, in logic, either be terminated, or a single person becomes a party to a contract with itself, whereas the most fundamental contract rules require at least two parties. As Circuit Judge Learned Hand said concerning treasury stock in *Borg* v. *International Silver Co.*, 11 F. (2d) 147, 150:

> "A corporation can have no right of action against itself, as must be if the share is truly a liability.
>
> * * * *
>
> "To carry the shares as a liability, and as an asset at cost, is certainly a fiction however admirable. They are not a liability and on dissolution could not be so treated, because the obligor and the obligee are one."

Both state corporation statutes and the courts have been pretty realistic about the real effect of a purchase of its own stock as a diminution of the assets of the

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[7] In the instant case the taxpayer and its common stockholders, through the managerial stock trust agreement, extended considerably the contractual relations established in the certificate of incorporation.

corporation. Some states forbid such purchases altogether, and in Delaware a corporation may use only its surplus to purchase shares of its own capital stock. As the Court stated in *In Re International Radiator Co.*, 10 Del. Ch. 358:

> "In other words, a corporation may use only its surplus for the purchase of shares of its own capital stock. 'Capital' does not in this connection, mean the assets of the company, for, of course, the assets are reduced when any of it is used by a corporation to purchase shares of its own capital stock."

The Government admits (Government Brief, page 18) that, under the accounting treatment customarily accorded dealings in treasury stock no gain or loss is entered and such stock is not carried as an asset on the balance sheet. While accounting principles are not legally controlling, yet it must be considered that they represent the expert judgment of a profession devoted to effective portrayal of the actual results of transactions and the real condition of business enterprises. This customary accounting treatment, moreover, has been followed and prescribed by the Securities and Exchange Commission. The Commission has been entrusted by Congress with the duty of seeing to it that issuers of securities make full and fair disclosure of facts and, in pursuance of that objective, is given authority to prescribe accounting rules and methods. Securities Act of 1933, Title I, Section 19, Title 15 USCA, Section 770.

Pursuant to that authority it issued its Accounting Series Release No. 6, of May 10, 1938, as follows:

> "Under the laws of most states there are certain legal restraints upon the issuance of new shares

that do not apply to the sale of treasury shares. However, from an accounting standpoint, there appears to be no significant difference in the final effect upon the company between (1) the reacquisition and resale of a company's own common stock and (2) the reacquisition and retirement of such stock together with the subsequent issuance of stock of the same class.

"It is recognized that when capital stock is reacquired and retired any surplus arising therefrom is capital and should be accounted for as such and that the full proceeds of any subsequent issue should also be treated as capital. Transactions of this nature do not result in corporate profits or in earned surplus. There would seem to be no logical reason why surplus arising from the reacquisition of the company's capital stock and its subsequent resale should not also be treated as capital."

Surely the judgment of the Commission with regard to the real nature of transactions by a company in its own stock is entitled to considerable respect.

Congress itself had no difficulty recognizing within its own legislative sphere that the purchase of its own stock by a national bank effected a withdrawal of the capital of the association. R.S. Sec. 5201, Title 12, USCA Sec. 83. This Court has recognized that the object and policy of this section is to prevent the reduction of the outstanding stock and the withdrawal *pro tanto* of the capital. *Hood* v. *Wallace*, 182 U.S. 555; *Deitrick* v. *Greaney*, 309 U.S. 697. And in *Lantry* v. *Wallace*, 182 U.S. 536, 553, it quoted with apparent approval the statement of the lower court that:

"'The sale of the stock to the defendant after the bank had purchased the same was not unlawful, since it operated to restore that part of the capital

that had been retired, and to that extent repaired the wrong which might otherwise have been done to the bank's creditors.' 38 C.C.A. 510, 514, 97 Fed. 865, 868."

The difficulty in logic[illegible]pplying usual rules to transactions in capital stock [illegible] apparent from the facts here. The corporation issued 18,574 shares of common stock to M. D. Anderson for $1 a share. Upon his death it paid his estate $943,373.46 or $50.79 a share to recover this stock. (R. 30)

Unless it is treated as a capital transaction it can be argued logically that this purchase of its stock cancelling as it does its previously outstanding contract, represents a closed transaction, and the proper time for computation of any profit or loss is upon the termination of that contract.[8] On the repurchase of the 18,574 shares, therefore, the taxpayer suffered a loss of $934,799.46.

A new contract was entered into when the corporation sold 3,035 shares to W. L. Anderson on December 22, 1939, at $32.27 a share, and the net assets were increased by the entire $97,939.43 paid in. (R. 30) The sale of another 6,500 shares to other managing officials at $112.68 a share increased the assets by $732,420. (R. 30) These contracts were still open and outstanding during the period involved here and would not result in closed transactions until they closed out.

Certainly, if these were debentures this method of determining when a transaction was closed would be

[8] Except upon such a theory the reasoning of *United States* v. *Kirby Lumber Company*, 284 U.S. 1, is inapplicable, and, upon such theory, taxpayer incurred a loss, or, if the differing nature of the stock contract is considered, realized neither gain nor loss.

followed, and to the extent a corporation can be separated from its shareholders the same analysis seems pertinent. When the 6,500 shares were issued to the managing officials, the corporation had simply assumed that much additional liability to them. As a matter of fact, in this particular case the liability was somewhat more than that usually incident to the stockholder-corporation relationship. The corporation was obligated at the option of the holder, to buy back the stock at its latest valuation (R. 28), and to take it back at any time in payment of the note of the purchaser. (R. 78.)

From the point of view of the stockholders prior to the transaction, too, it is difficult to see how their position was improved by the sale of the 6,500 shares for their equivalent value of $112.68, since that price was designed to place the new shareholders in exactly the same position as the old. (Findings 26 and 27, R. 29)

The Decisions of the Courts of Appeal Cited by the Government Ignore the Plain Terms of the Applicable Regulations and Rest Entirely on the Failure of the Taxpayers to Go Through the Formal Mechanics of Actually Retiring the Stock and Issuing New Stock

The Government places its principal reliance upon four decisions of the Courts of Appeal, reversing the Tax Court, which had uniformly refused to hold that the Treasury regulations made taxable a sale of treasury shares "for the purpose of satisfying contractual obligations, equalizing shareholdings, eliminating a participant wishing to retire, implementing an employee profit sharing plan, or keeping the ownership of the corporation within a particular group". (R. 21)

These Courts of Appeal decisions built up on each other like a house of cards. In *Commissioner v. Batten; Barton, Durstine & Osborn, Inc.*, (1948) 171 F. (2d) 474, there were three opinions. Circuit Judge Chase thought that any sale of treasury stock by a corporation constituted dealing in its own stock under the regulations. Circuit Judge Frank concurred on authority of *Aviation Capital v. Pedrick*, (1945) 148 F. (2d) 165, though he thought "it irrational ever to consider 'treasury stock' as a capital asset in these tax cases," and stated that the situation was to his mind like that in a farce:

> "An untenable premise, once adopted, is to be carried out logically."

Circuit Judge Swan dissented on the ground that he agreed with the Tax Court that the taxpayer did not deal in its own shares as it would the shares of another corporation.

Its reasons were stated by the Tax Court in the *Batten* case, 9 T.C. 448, as follows:

> "We sum up our reasons for thinking that petitioner was not dealing in its own shares 'as it might in the shares of another corporation' as follows:
>
> "All sales were made on terms that permitted the employee to turn back his shares which were not paid for and were held by petitioner as collateral, at his purchase price at any time within seven years. No business corporation would deal in the shares of another corporation in that manner as a general method of doing business. In our opinion no business corporation dealing in shares of another corporation would invariably commit itself to repurchase, at book value, the holdings of each and every purchaser upon

> the death, resignation or retirement of that purchaser. Yet that is what the taxpayer did in the case at bar. This followed from the fact that all outstanding shares are held subject to the stockholder's agreement. It is stipulated that during the taxable years in question "all purchases and sales were made at book value"; there was no negotiation as to price. The taxpayer did not carry its treasury stock on its books as an asset. The taxpayer did not attempt to choose a time favorable to it for the purchase or sale of shares. For these and other reasons, we do not think petitioner was dealing in its own shares of stock "as it might in the shares of another corporation." ' "

Upon the authority of the decision in *Commissioner v. Batten, Barton, Durstine & Osborn, Inc.*, (1948) 171 F. (2d) 474, the Court of Appeals for the Seventh Circuit reversed the Tax Court in *Commissioner v. Rollins Burdick Hunter Co.*, (1949) 174 F. (2d) 698, with Chief Judge Major dissenting on the ground that the "undisputed facts clearly demonstrate that the taxpayer did not deal in its own shares as it might in the shares of another corporation".

Those facts were summarized by the Tax Court in the *Rollins* case, 9 T.C. 169, 170, as follows:

> "The stipulated facts amply demonstrate that the petitioner was not dealing in its own shares as it might in the shares of another corporation. The price at which the petitioner should acquire any shares was fixed in advance by agreement. The petitioner had no profit motive in buying or selling, but was merely arranging that its shares should be held, and held only, by those who were its officers and principally responsible, through their personal services, for its success and should be held by them in proportion to their relative abilities

to contribute personal services of value to the petitioner. Those purposes could not be accomplished by dealing in any other stock. The petitioner did not buy stock and sell it to create employee interest. It bought, as was required by agreement, so that the stock would never get into outside hands, but would be used only to indicate ownership in the business by those principally responsible for its success. The purchases and sales readjusted the capital for this purpose only. The transaction, viewed as a whole, was not one giving rise to taxable gain under Section 22(a) and the regulations."

The Court of Appeals for the Third Circuit was next, its decision in *Commissioner* v. *H. W. Porter & Co.*, (1951) 187 F. (2d) 939, relying upon the decisions in *Commissioner* v. *Batten, Barton, Durstine & Osborn, Inc.*, 171 F. (2d) 474, and *Commissioner* v. *Rollins Burdick Hunter Co.*, 174 F. (2d) 698. The Tax Court, 14 T.C. 307, had stated its reasons for refusing to follow the Courts of Appeals as follows:

"In applying the principle this Court has deemed such dealings, when not carried out for the purpose of a prospective profit, but to satisfy a contractual obligation, equalize shareholdings, *Dr. Pepper Bottling Co. of Mississippi*, 1 T.C. 80, eliminate a participant wishing to retire, *Brockman Oil Well Cementing Co.*, 2 T.C. 168, or implement a profit-sharing plan for employees, *Cluett, Peabody & Co.*, 3 T.C. 169, as not dealings which the corporation might carry out in the shares of another corporation, and has held the resulting profit on disposition nontaxable. On facts substantially similar to those here established, we applied the same reasoning and reached the same conclusion in *Rollins Burdick Hunter Co.*, 9 T.C. 169 and in *Batten, Barton, Durstine & Osborn, Inc.*, 9 T.C. 448. The former decision was re-

versed by the Court of Appeals for the Seventh Circuit, 174 Fed. (2d) 698, and the latter by the Second Circuit, 171 Fed. (2d) 474. We are not unmindful of these reversals of our holdings, but we note that in each case the opinion of the Court of Appeals was by a divided court. Moreover, after a careful consideration of the facts and the question here involved, a question which we have a number of times considered over a period of years, we are respectfully constrained to follow our holdings in these and the other cases mentioned above for the reasons therein stated. We have reached the conclusion that petitioner here was not dealing in its own shares 'as it might in the shares of another corporation,' and we accordingly reverse respondent's determination of a taxable gain of $11,800 on petitioner's disposition of the 236 shares in 1943."

And finally in *Commissioner* v. *Landers Corp.*,[9] (1954) 210 F. (2d) 188, the Court of Appeals for the Sixth Circuit followed the three decisions just cited, regarding as immaterial the following facts stated by the Tax Court at 11 T.C.M. 577:

"The record clearly shows that the petitioner never purchased its own shares except as an accommodation upon solicitation of the seller, never purchased them as an investment, never purchased them for the purpose of realizing a profit, cancelled them, treated them as retired, did not intend to resell them when it acquired them, and only resold them for reasons which developed later. The sale of 10 shares to a new director accom-

[9] Directly contrary to the opinion of the Court in *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U.S. 110, this Court of Appeals seems to think that no binding effect could be given a regulation excluding gain on treasury stock sales from taxable income. It seems also to give the dictum in *S. A. Woods Machine Co.*, 57 Fed. (2d) 635, authority much beyond its proper scope.

plished a purpose which could not have been accomplished by the sale of shares of another corporation. The sale of the remaining shares was to raise additional capital for expansion and refitting. The petitioner did not deal in its own shares as it might have dealt in the shares of another corporation. The petitioner realized no taxable gain from the sales of its own shares in 1946."

The Government also refers to the fact that in *Burrus Mills* v. *Commissioner*, 22 T.C. 881, filed July 14, 1954, (On Appeal, Fifth Circuit), the day after the decision in the pending case, the Tax Court changed its position. It did, stating:

"We decide the issue for respondent following the Courts of Appeals decisions cited above."

In the language of Circuit Judge Frank:[10]

"An untenable premise once adopted, is to be carried out logically."

Taxpayer cannot summarize the basic untenable premises on which these decisions of the Courts of Appeals are based in language as plain and compelling as that of the Court of Claims. (R. 22-23)

There Is No Significant Distinction Between Unissued and Treasury No Par Common Stock. But at the Most Such Trivial Formal Difference Was Properly Considered by the Court Below as One Factor Among All Other Facts and Circumstances

The Court of Claims determined that under the particular facts of this case any distinction between treasury stock and unissued stock was one of form.

[10] *Commissioner* v. *Batten, Barton, Durstine & Osborn, Inc.*, 171 F. (2d) 474, 477.

The Government strives continuously to get away from the particular facts here to generalities. The stock involved is no par stock, expressly excepted from any preemptive rights, and Delaware decisions cited in the attempt to develop some difference of substance between treasury and unissued shares (Government Brief, page 42) are inapplicable. Just as in the case of treasury stock Directors may fix the consideration for unissued no par stock at any amount they choose, and in the absence of actual or constructive fraud, the courts will not interfere. *Bodell et al. v. General Gas & Electric Corp.*, 15 Del. Ch. 119, 129, 427.

Contrary to the Government's argument (Government Brief, p. 43) no feature of Delaware law would have prevented taxpayer from retiring the 18,574 shares of common stock in 1939 when it was acquired from Anderson, and reissuing it to Whittington and others in 1943. While the Delaware courts in *Starring v. American H & F Corp.*, 21 Del. Ch. 380, 389, affirmed 21 Del. Ch. 431,[11] disapproved as discriminatory and unfair a corporate plan to retire all its common stock and to reissue it immediately to some stockholders but to eliminate others, the Delaware law contemplates and permits the reissuance of stock previously retired. It expressly provides that "the shares so retired * * * shall * * * if the certificate of incorporation does not prohibit the reissue thereof, have the status of authorized and unissued shares of the class of stock to which such shares belong". Section 28, General Corporation Law, now Section 244, Title 8, Delaware Code of 1953. The corporate charter here specifically authorized such reissue. (R. 54)

[11] The Delaware court also questioned whether a corporation could retire common stock when there is no asset value attributable to it.

In accordance with the obligation of its agreement taxpayer purchased the 18,574 shares owned by M. D. Anderson at the date of his death in 1939, and the present transaction did not occur until December 18, 1943. (R. 43) Clearly, taxpayer might have retired the shares purchased in 1939, reducing its outstanding capital by $18,574 to $32,769,582, but such action could scarcely have been regarded as anything but a silly formality, both because other charter and contractual provisions accomplished the same substantial effect, and because the amount involved was inconsequential.

And equally clearly, taxpayer would have been entirely free insofar as the Certificate of Incorporation is concerned, to sell these unissued shares at any price the directors determined. The same standard of reasonableness and fairness would have applied whether the shares sold were unissued or treasury shares.

The Government seems to argue (Government Brief, p. 43) that it would "exalt form above substance" to attach any importance to whether the taxpayer went through "the motions of retiring the reacquired shares and replacing them with an equivalent number of new ones." The Court of Claims thought so, too, in its consideration of all the facts and circumstances, and found the formal difference insufficient to support the Government's position.[12]

Every significant right represented by the stock disappeared in the corporate treasury. It could not

[12] In this apparently unintentional agreement with the Court of Claims the Government overlooks the express provision of its own Regulation that:

> "The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss * * *."

share in distribution of dividends or of assets upon liquidation. It was excluded from consideration in calculation of the Common Stock Surplus. (Finding 16, R. 27) No voting right existed. As the Delaware Chancery Court said in *Allenberg* v. *Consolidated Copper Mining Corporation*, 20 A. (2d) 743:

> "The treasury shares could not be voted, for Section 19 of The Delaware Corporation Law provides that '* * * shares of its own capital stock belonging to the corporation shall not be voted upon directly or indirectly * * *.' Consequently, it would seem wholly unreasonable to count them in computing a quorum. As between the stockholders and the corporation, treasury stock, which represents no effective obligation against the corporation, is not 'outstanding'. *Borg* v. *International Silver Co.*, 2 Cir., 11 F. (2d) 147; *Scheind* v. *Otis Hatcher Co., et al.*, 204 Ky. 289, 264 S.W. 755. The expression 'outstanding capital stock' as used in the bylaw should be construed to mean stock in the hands of shareholders, not stock in the treasury."

The difference between treasury and unissued shares is not regarded as significant at other points in tax law.

The question of whether any importance is to be attached to the use of treasury rather than newly issued stock has arisen in several other connections. A dividend in treasury stock is a non-taxable stock dividend. The proceeds of stock redeemed and held in the treasury can be equivalent to a cash dividend. The amount paid out for treasury stock must be eliminated from invested capital for excess profits tax purposes.

(a) Dividends in treasury stock

Though *IT 2449*, VIII-1 C.B. 101, previously ruled that dividends in treasury stock constituted exempt stock dividends, the Treasury attempted in its Regulations under the 1936 Act to place treasury stock in a different category from unissued stock for stock dividend purposes. It provided that dividends paid in property were taxable, defined property to include shares of capital stock of the corporation if held as an investment, and provided that shares once issued but later reacquired in any manner but not retired should be deemed to be held as an investment.

In *Bruckheimer* v. *Commissioner*, (1942) 46 B.T.A. 234, the Tax Court held that it made no difference that the stock which was distributed was treasury stock. It said:

> "The argument of respondent is based largely upon an assumption that the reacquired stock was an asset, property, of the corporation. That assumption appears to be against the weight of authority. Treasury stock is usually regarded as 'retired' in the sense that it no longer constitutes a liability of the corporation because a corporation can have no right of action against itself. See *Borg* v. *International Silver Co.*, 11 Fed. (2d) 147, 150, where it was said by the Circuit Court of Appeals for the Second Circuit:
>
> > " 'Indeed, the only difference between a share held in the treasury and one retired is that the first may be resold for what it will fetch on the market, while the second has disappeared altogether. * * * They (Treasury stock) are not a present asset, because, as they stand, the defendant (the corporation) cannot collect upon them. What in fact they are is an opportunity to

acquire new assets for the corporate Treasury by creating new obligations.'

Most authorities lead to the view that treasury stock is not stock at all. See Virginia Law Review, vol. 15, pp. 637, 638, where it is said:

> '* * * Whenever a corporation gives *anything* for its own stock, the corporation is out an asset. Against that it has left only the possibility that some day, under some circumstances, it may succeed in getting value back into the treasury to replace the value it has lost, by the process of again selling this 'treasury stock' which meanwhile, in actual truth, represents a void.'

See also Model Corporation Act, Harvard Law Review, vol. 48, p. 1373: 'Treasury shares shall not be considered or carried as an asset for any purpose.'

> "In our opinion it is an exceedingly doubtful theory that reacquired stock such as is involved here is to be treated as 'property' in the way that stock of another corporation held in a corporation's assets is property. Unless it can be held that the stock which was distributed to petitioner was 'property', as in the latter instance, we cannot hold that the petitioner realized 'income' upon receipt of the stock in question. To whatever extent article 27(c)-1 of Regulations 94 is appropriately applicable here, it must be concluded that the stock dividend in question was not paid in 'property' of the corporation." (239-40)

The Commissioner appealed to the Circuit Court of Appeals for the Second Circuit but dismissed his appeal on July 13, 1943, and acquiesced in the decision, 1943, C.B. 4; and in *T.D. 5290,* 1943 C.B. 366, the Treasury provided that a distribution of stock which would otherwise be non-taxable should not be treated

differently "merely because such distribution was made out of treasury stock."

(*b*) *Redemption for treasury equivalent to a dividend.*

The status of "treasury stock" has been actively considered by the courts in respect to another aspect of tax law in which the Government position has differed from that taken here. Section 115(g) provided that if a corporation "cancels or redeems" its stock, at such time or in such manner as to make the cancellation or redemption essentially equivalent to the distribution of a taxable dividend, it should be taxed as a dividend. The Government position has been that it makes no difference that the stock is held in the treasury and is not actually legally cancelled and retired, that the substance of the transaction is the purchase by the corporation, and the Courts have agreed. *Robinson* v. *Commissioner*, 69 F. (2d) 972; *Kirschenbaum* v. *Commissioner*, 155 F. (2d) 23; *Wall* v. *United States*, 164 F. (2d) 462.

In *Wall* v. *United States*, 164 F. (2d) 462, 465, the Court of Appeals said:

> "The taxpayer also contends that the statute does not fit his case because the Coleman stock was neither cancelled nor redeemed but kept alive in the company's treasury so that, if need be, it could be reissued. The proper method of treating or accounting for the stock of a corporation purchased by it and kept in its treasury has been the subject of much discussion; but it is clear that for tax purposes, the question whether such stock may be regarded as redeemed should be solved by an examination of the attendant circumstances. R.J. Reynolds Tobacco Co. v. Commissioner, 4 Cir., 97 F. 2d 302. As a practical matter, such shares are

redeemed in the sense that they no longer constitute any liability of the corporation but represent nothing more than an opportunity to acquire new assets by a reissuance. Borg v. International Silver Co., 2 Cir., 11 F. 2d 147, 150. We have no difficulty in reaching the conclusion in this case that the shares were redeemed in the statutory sense. They were purchased from Wall who was in effect the sole stockholder of the corporation to relieve him of his obligations to Coleman, and when they were acquired by the corporation, they ceased to have any present significance or vitality. In the words of the statute the distribution and redemption were essentially equivalent to the distribution of a taxable dividend. If it should be held that taxpayers can avoid the terms of the statute by the simple device of selling their stock to the corporation and having it held as treasury stock, the purpose of the statute to prevent the evasion of taxes upon corporate dividends would be completely frustrated."

Treasury Regulation 111 Sec. 29.115-9; rather like those here involved but not so emphatically, provided that the question whether a distribution in connection with the cancellation or redemption of stock is essentially equivalent to the distribution of a taxable dividend depends "upon the circumstances of each case".

The courts have reached their conclusions "upon the circumstances of each case" and their conclusions have varied with the circumstances, but none of them have regarded the fact that the stock was retained in the treasury to be of controlling importance. *Keefe* v. *Cote*, 213 F. (2d) 651; *Zenz* v. *Quinlivan*, 213 F. (2d) 914; *Boyle* v. *Commisisoner*, 187 F. (2d) 557; *Commissioner* v. *Snite*, 177 F. (2d) 819.

In the *Snite* case last cited the Court of Appeals for the Seventh Circuit said:

> "The Tax Court disposed of these citations by the following remarks: 'Respondent insists it is now established law that the net effect of the transaction, rather than the motives and purposes of the corporation or its stockholders, is the test of taxability. It must be recognized that the net effect rationale inheres in a number of decisions. See *Bazley* v. *Commissioner*, 331 U.S. 737 (67 S. Ct. 1489, 91 L. Ed. 1782, 173 A.L.R. 905); *Hirsch* v. *Commissioner* (9 Cir.), 124 F. 2d 24; *Flanagan* v. *Helvering*, (73 App. D.C. 46), 116 F. 2d 937; *Hyman* v. *Helvering* (63 App. D.C. 221), 71 F. 2d 342; cf. *Commissioner* (of Internal Revenue) v. *Bedford's Estate*, 325 U.S. 283 (65 S. Ct. 1157, 89 L. Ed. 1611). But all that this means is that no one factor is controlling. It surely does not mean that the mere existence of sufficient earnings and profits to cover the acquisition of the stock automatically brings the transaction within the provisions of Section 115(g). If that were so, it would seem that practically no room would be left for the operation of the provisions of Section 115(g) relating to distributions in partial liquidation. Just as the presence of a legitimate business purpose will not, standing alone, conclusivel determine that Section 115(g) is inapplicable, so the mere fact that the corporation has sufficient surplus available does not conclusively determine that the section is applicable. All relevant factors must be considered in determining the net effect of the transaction.' With this language we agree. As Judge Vinson, now Chief Justice, said in *Flanagan* v. *Helvering*, 73 App. D.C. 46, 116 F. 2d 937, 939: 'The phrases 'in such manner' and 'essentially equivalent' negative any idea that a weighted formula can resolve the one crucial issue —shall the distribution be treated as a taxable dividend.' And the Treasury Regulations, 111,

Sec. 29, 115-9, themselves provide that whether a distribution in connection with a cancellation or redemption of stock is essentially equivalent to the distribution of a taxable dividend depends upon the circumstances of each case. It seems to us that the court below rightfully decided that, in determining whether the distribution made to the taxpayer was essentially of the character of a dividend, all the factors and all the circumstances should be considered and the net result determined therefrom."

(c) Treasury stock eliminated from invested capital.

The Treasury's approach to another problem involving the acquisition and disposition of its own stock by a corporation has been more realistic. Under the excess profits tax effective in World War I, the purchase of its own stock effected a reduction of the invested capital of a corporation and its sale effected an increase. *Fairmont & Cleveland Coal Co.*, 12 B.T.A. 1296; *Johnson & Co., Inc. v. Noel*, 25 F. (2d) 670.

In Regulations 130 issued under the more recent excess profits tax act, the Treasury ruled:

"Reg. 130, Sec. 40.458-5. (e) The purchase by a corporation of its own stock for investment does not of itself result in a reduction of equity invested capital. But see section 40.440-1 relative to inadmissible assets. If, however, the corporation subsequently cancels such stock, equity invested capital is reduced, beginning with the day following such cancellation, by so much of the adjusted basis of such stock in the hands of the corporation as is not properly chargeable to earnings and profits of the taxable year. If stock is purchased for retirement, there is a distribution on the date of purchase of the amount paid therefor and the equity invested capital is reduced by the amount

thereof not properly chargeable to earnings and profits of the taxable year."

Unless the stockholder could prove that the stock was reacquired for "investment", the purchase price was deducted from invested capital. Under Regulations 112, Section 35.718-5, the Tax Court said in *Christman Co.* v. *Commissioner*, 8 T.C. 679, 688, affirmed 166 F. (2d) 1016:

> "The reacquisition of each share had the effect of distributing $10 of capital, the payment out of what had originally been paid in, and there would be no sound reason for regarding that money, no longer at risk in the business, as a part of equity invested capital."

In the same case, p. 688, the Tax Court expressly stated:

> "The provisions of section 720 and of Regulations 112, section 25.720-1, relating to inadmissible assets, have been considered, but they do not complicate the present issue. The stock presently under consideration was not an asset of the petitioner during the taxable years (*Borg* v. *International Silver Co.*, 11 Fed. (2d) 147; *David Bruckheimer, supra*), and is not within section 720."

That the word "investment" is an important qualification is indicated by the Court in the following statement from *La Belle Iron Works* v. *United States*, 256 U.S. 377, 388:

> "* * * The word 'invested' in itself imports a restrictive qualification. When speaking of the capital of a business corporation or partnership, such as the act deals with, 'to invest' imports a laying out of money, or money's worth, either by

an individual in acquiring an interest in the concern with a view to obtaining income or profit from the conduct of its business, or by the concern itself in acquiring something of permanent use in the business; in either case involving a conversion of wealth from one form into another, suitable for employment in the making of the hoped-for gains."

So in each of these fields the courts have, at times with Treasury assistance and at times despite Treasury opposition, recognized the substantial indistinguishability of treasury and unissued shares. In their approach to the questions, moreover, the courts have required consideration of all relevant factors including the view or purpose underlying the transaction.

CONCLUSION

The decision of the Court of Claims, after consideration of all the undisputed facts and circumstances, that taxpayer did not deal in its own stock as it might the stock of another corporation and that the real nature of the transaction involved was such that it was not brought within the scope of Section 22(a) by the Treasury Regulations is correct. Its judgment should be affirmed.

Respectfully submitted,

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